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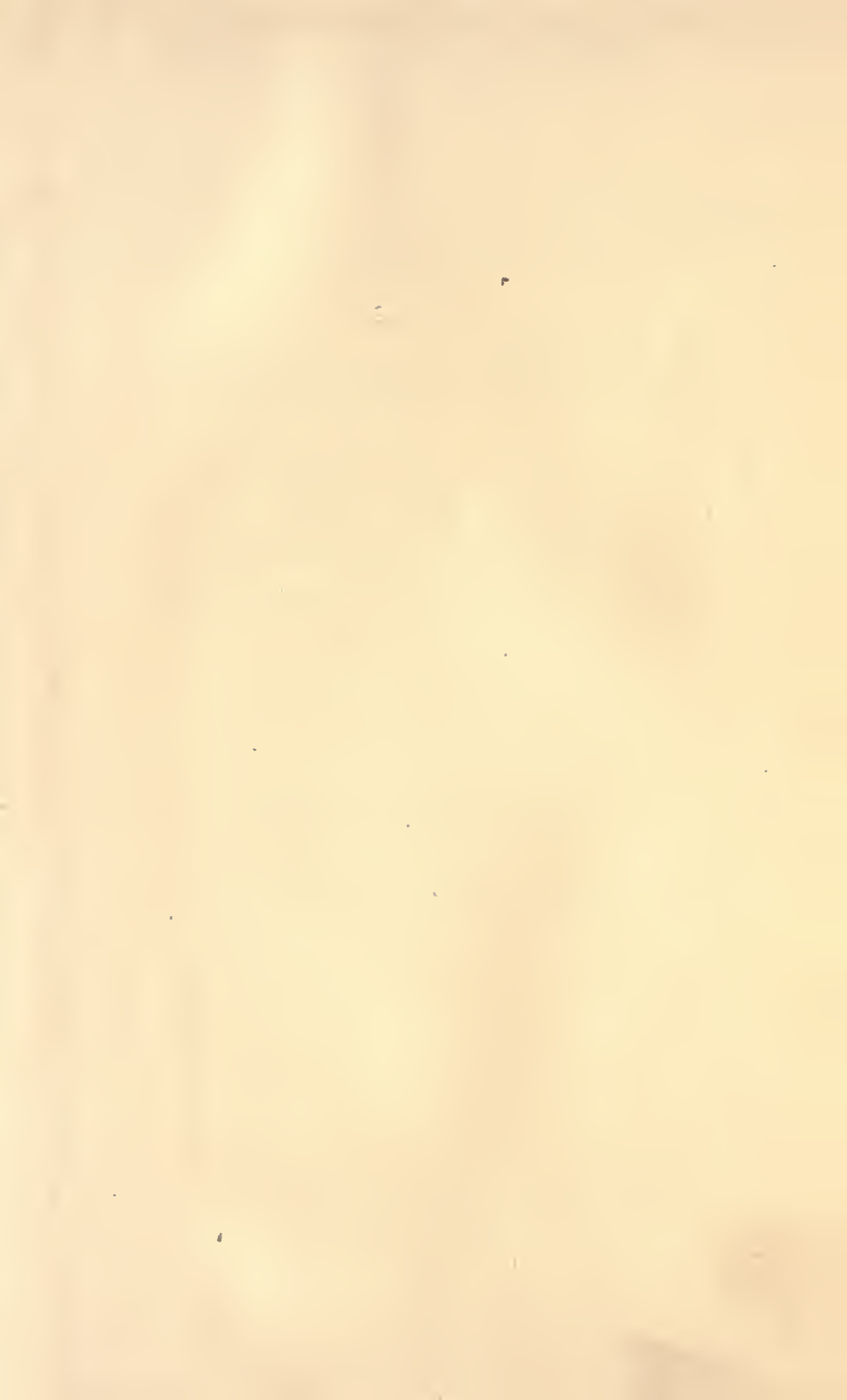














HORNBOOK CASE SERIES

ILLUSTRATIVE CASES  
ON  
CORPORATIONS

BY

I. MAURICE WORMSER

PROFESSOR OF THE LAW OF CORPORATIONS, FORDHAM UNIVERSITY  
SCHOOL OF LAW

A COMPANION BOOK  
TO  
CLARK ON CORPORATIONS (3d ED.)

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To

HONORABLE IRVING LEHMAN

*Justice of the Supreme Court of the State of New York,*

*as a slight token of the author's esteem,  
this volume is dedicated*

(iii)\*



# THE HORNBOOK CASE SERIES

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It is the purpose of the publishers to supply a set of Illustrative Casebooks to accompany the various volumes of the Hornbook Series, to be used in connection with the Hornbooks for instruction in the classroom. The object of these Casebooks is to illustrate the principles of law as set forth and discussed in the volumes of the Hornbook Series. The text-book sets forth in a clear and concise manner the principles of the subject; the Casebook shows how these principles have been applied by the courts, and embodied in the case law. With instruction and study along these lines, the student should secure a fundamental knowledge and grasp of the subject. The cases on a particular subject are sufficiently numerous and varied to cover the main underlying principles and essentials. Unlike casebooks prepared for the "Case Method" of instruction, no attempt has been made to supply a comprehensive knowledge of the subject from the cases alone. It should be remembered that the basis of the instruction is the text-book, and that the purpose of these Casebooks is to illustrate the practical application of the principles of the law.

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## AUTHOR'S PREFACE

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THE law of corporations is a rapidly growing subject. No branch of the law reflects more fully the constant changes in our body politic,—economic, sociological, and ethical. The author's aim in this volume has been to present a collection of decisions which fairly represents the law of corporations as it is to-day. Particular attention has been paid to such branches of the law as are now in the making, and for that reason the attention of the student has been focussed primarily upon these topics, although fundamental principles have never been lost sight of. At the same time, it must be understood that this volume is essentially an "illustrative" casebook, and that it is designed for use in connection with the author's edition of *Clark on Corporations*, 3d Ed.

Acknowledgment is made to Professor Robert D. Petty, of the New York Law School, for his generous assistance, and to Hon. Frank White for permission to use certain of the excellent forms contained in *White on Corporations*. These corporate forms reflect the experience of many years and are authoritative.

Finally, the author wishes to make acknowledgment to his many past and present students in the law of private corporations at Fordham, Columbia, and Illinois Universities. Their stimulating questions and suggestions have been of much service in determining what portions of the general subject should properly be emphasized in a casebook.

I. MAURICE WORMSER.

35 Nassau Street, New York City.

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# HORNBOOK CASES

## ON THE

# LAW OF CORPORATIONS

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### OF THE NATURE OF A CORPORATION

#### I. The Corporation as a Legal Entity <sup>1</sup>

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##### BUTTON v. HOFFMAN.

(Supreme Court of Wisconsin, 1884. 61 Wis. 20, 20 N. W. 667, 50 Am. Rep. 131.)

Appeal from the Circuit Court for Jackson County.

Replevin. The defendant appealed from a judgment in favor of the plaintiff.

ORTON, J. This is an action of replevin in which the title of the plaintiff to the property was put in issue by the answer.

In his instructions to the jury the learned judge of the circuit court said: "I think the testimony is that the plaintiff had the title to the property." The evidence of the plaintiff's title was that the property belonged to a corporation known as "The Hayden & Smith Manufacturing Company," and that he purchased and became the sole owner of all of the capital stock of said corporation. As the plaintiff in his testimony expressed it, "I bought all the stock. I own all the stock now. I became the absolute owner of the mill. It belonged at that time to the company, and I am the company." There was no other evidence of the condition of the corporation at the time. Is this sufficient evidence of the plaintiff's title? We think not. The learned counsel of the respondent in his brief says: "The property had formerly belonged to the Hayden & Smith Manufacturing Company, but the respondent had purchased and become the owner of all the stock of the company, and thus became its sole owner."

From the very nature of a private corporation, or, indeed, of any corporation, the stockholders are not the private and joint owners of its property. The corporation is the real, though artificial, person substituted for the natural persons who procured its creation and have pecuniary interests in it, in which all its property is vested, and by

<sup>1</sup> For discussion of principles, see Clark on Corp. (3d Ed.) §§ 1-3.

which it is controlled, managed and disposed of. It must purchase, hold, grant, sell and convey the corporate property, and do business, sue and be sued, plead and be impleaded, for corporate purposes, by its corporate name. The corporation must do its business in a certain way, and by its regularly appointed officers and agents, whose acts are those of the corporation only as they are within the powers and purposes of the corporation. In an ordinary co-partnership the members of it act as natural persons and as agents for each other, and with unlimited liability. But not so with a corporation; its members, as natural persons, are merged in the corporate identity. Ang. & A. on Corp. §§ 40, 46, 100, 591, 595. A share of the capital stock of a corporation is defined to be a right to partake, according to the amount subscribed, of the surplus profits obtained from the use and disposal of the capital stock of the company to those purposes for which the company is constituted. Id., sec. 557. The corporation is the trustee for the management of the property, and the stockholders are the mere cestuis que trust. Gray v. Portland Bank, 3 Mass. 365, 3 Am. Dec. 156; Eidman v. Bowman, 58 Ill. 444, 11 Am. Rep. 90, 4 Am. Corp. Cas. 350. The right of alienation or assignment of the property is in the corporation alone, and this right is not affected by making the stockholders individually liable for the corporate debts. Ang. & A. on Corp. § 191; Pope v. Brandon, 2 Stewart (Ala.) 401, 20 Am. Dec. 49; Whitwell v. Warner, 20 Vt. 444. The property of the corporation is the mere instrument whereby the stock is made to produce the profits, which are the dividends to be declared from time to time by corporate authority for the benefit of the stockholders, while the property itself, which produces them, continues to belong to the corporation. Bradley v. Holdsworth, 3 Mees. & W. 422; Waltham Bank v. Waltham, 10 Metc. (Mass.) 334; Tippetts v. Walker, 4 Mass. 595. The corporation holds its property only for the purposes for which it was permitted to acquire it, and even the corporation cannot divert it from such use, and a shareholder has no legal right to it, or the profits arising therefrom, until a lawful division is made by the directors or other proper officers of the corporation, or by judicial determination. Ang. & A. on Corp. §§ 160, 190, 557; Hyatt v. Allen, 56 N. Y. 553, 15 Am. Rep. 449, 4 Am. Corp. Cas. 624. A conveyance of all the capital stock to a purchaser gives to such purchaser only an equitable interest in the property to carry on business under the act of incorporation and in the corporate name, and the corporation is still the legal owner of the same. Wilde v. Jenkins, 4 Paige (N. Y.) 481. A legal distribution of the property after a dissolution of the corporation and settlement of its affairs, is the inception of any title of a stockholder to it, although he be the sole stockholder. Ang. & A. on Corp. § 779a.

These general principles sufficiently establish the doctrine that the owner of all the capital stock of a corporation does not therefore own its property, or any of it, and does not himself become the corporation, as a natural person, to own its property and do its business in his own

name. While the corporation exists he is a mere stockholder of it, and nothing else. The consequences of a violation of these principles would be that the stockholders would be the private and joint owners of the corporate property, and they could assume the powers of the corporation, and supersede its functions in its use and disposition for their own benefit without personal liability, and thus destroy the corporation, terminate its business, and defraud its creditors. The stockholders would be the owners of the property, and, at the same time, it would belong to the corporation. One stockholder owning the whole capital stock, could, of course, do what several stockholders could lawfully do. It is said in *Utica v. Churchill*, 33 N. Y. 161, "the interest of a stockholder is of a collateral nature, and is not the interest of an owner;" and in *Hyatt v. Allen*, *supra*, that "a shareholder in a corporation has no legal title to its property or profits until a division is made." In *Winona & St. P. R. R. Co. v. St. P. & S. C. R. R. Co.*, 23 Minn. 359, it is held that the corporation is still the absolute owner, and vested with the legal title of the property, and the real party in interest, although another party has become the owner of the sole beneficial interest in its rights, property and immunities. In *Baldwin v. Canfield*, 26 Minn. 43, 1 N. W. 261, 276, it was held that the sole owner of the stock did not own the land of the corporation so as to convey the same. In *Bartlett v. Brickett*, 14 Allen (Mass.) 62, an action of replevin was brought by A, B, and C, as the "Trustees of the Ministerial Fund in the North Parish in Haverhill," which was the corporate name. In portions of the writ the plaintiffs were referred to as "the said trustees" and "the said plaintiffs." In the bond, "A, B, and C, trustees as aforesaid," became bound, and the officer, in his return, certified that he had taken a bond "from the within-named A, B, and C," and the property was receipted by "A, B, and C, plaintiffs." It was held that the action was not by the corporation, as it should have been, and judgment was rendered for the defendant. It is said in *Van Allen v. Assessors*, 3 Wall. 584, 18 L. Ed. 229, "the corporation is the legal owner of all the property of the bank, both real and personal." In *Wilde v. Jenkins*, *supra*, where a co-partnership bought all the property and effects, together with the franchises, of a corporation, and elected themselves trustees of the corporation, it was held that the corporation was not dissolved, and that the legal title to the real and personal property was still in the corporation for their benefit. In *Mickles v. R. C. Bank*, 11 Paige (N. Y.) 118, 42 Am. Dec. 103, it was held that, although a corporation was deemed to have surrendered its charter for a nonuser, it was not dissolved, and would not be until its dissolution was judicially declared, and that until then its property could be taken and sold by its judgment creditors. In *Bennett v. Am. Art Union*, 5 Sandf. (N. Y.) 614, it was held that, "as a general rule, the whole title, legal and equitable (to its property), is vested in the corporation itself," and that the individual members have no other or greater interest in it than is expressly given to them by the charter,



and the prayer of the complainant, as a shareholder in the Art Union, for an injunction against a certain disposition of its property, was denied, because he had no interest in it. See, also, *Goodwin v. Hardy*, 57 Me. 143, 99 Am. Dec. 758.

It is true that none of the above cases are precisely parallel with the present case in facts, but they are sufficiently analogous to be authority upon the principle that the plaintiff, as the sole stockholder of the corporation, is not the legal owner of its property. He may have an equitable interest in it, but in this action he must show a legal title to the property in himself in order to recover, and he has shown that such title is in another person. *Timp v. Dockham*, 32 Wis. 146; *Sensenbrenner v. Mathews*, 48 Wis. 250, 3 N. W. 599, 33 Am. Rep. 809. In analogy to the above principle it was held in *Murphy v. Hanrahan*, 50 Wis. 485, 7 N. W. 436, that the sole heirs of an estate did not have such a legal title to a promissory note given to their father as would entitle them to sue the maker upon it, because the title to it was in the administrator, and they could obtain the title only by administration and distribution according to law. The heirs in that case certainly had as much equitable interest in that note as this plaintiff has in the property in controversy. The want of title to the property being fatal to the plaintiff's recovery in the action between the present parties, other alleged errors will not be considered.

The judgment of the circuit court is reversed and the cause remanded for a new trial.

## MOORE & HANDLEY HARDWARE CO. v. TOWERS HARDWARE CO.

(Supreme Court of Alabama, 1888. 87 Ala. 206, 6 South. 41, 13 Am. St. Rep. 23.)

Appeal from the Chancery Court of Jefferson.

Heard before Hon. Thomas Cobbs.

The bill in this case was filed on the 3d December, 1888, by the Towers Hardware Company, a private corporation, against the Moore & Handley Hardware Company, another private corporation; and sought an injunction to restrain the defendant from selling "plow-stocks and plow-blades," in violation of a contract made between the complainant and a partnership doing business under the name of Moore, Moore & Handley, which was composed of James D. Moore, Benj. F. Moore, and William A. Handley, who, as the bill alleged, afterward formed the defendant corporation. The complainant was incorporated, under the general statutes, on the 1st February, 1887, and the defendant on the 12th March, 1888; each having its principal place of business in Birmingham, and selling hardware throughout the northern counties of the state, mostly on orders effected through their traveling salesmen. The partnership of Moore, Moore & Handley had been engaged in the same business, and on the 27th May, 1887, they sold

out their entire stock of plow-stocks and plow-blades, at the price of \$728 paid in cash, to the complainant; signing an agreement, which was written at the foot of the memorandum, or bill of sale, in these words: "In consideration of above sale, we agree not to handle any more plow-stocks or plow-blades, except railroad plows." The bill alleged that the price paid was about \$100 more than the market value of the articles, and that complainant was induced to make said purchase "solely by said written promise and undertaking of said Moore, Moore & Handley." By the terms of defendant's articles of incorporation, its capital stock was \$100,000, of which said partners each subscribed \$25,000, and one Thos. P. Wimberly \$25,000; but the bill alleged that, "if said Wimberly ever really had any interest in said corporation, or the capital stock thereof, by virtue of having paid anything on his subscription, he no longer has any interest therein, nor has had since before (to wit) August 8th, 1888;" also, on information and belief, that said Moores and Handley "are the sole owners of the capital stock of said corporation, and have been since August 10th, 1888," J. D. Moore being president, Handley vice-president, and B. F. Moore secretary, ever since its organization; that the defendant corporation was organized for the purpose of carrying on the same business which the partnership had carried on; that its capital stock "was paid for wholly and entirely in the stock of goods and assets of said partnership;" that it "succeeded to all the property rights and assets of said partnership, as well as all the liabilities thereof;" that said defendant corporation is none other than said J. D. Moore, B. F. Moore and Wm. A. Handley, who constituted said partnership, and now constitute said corporation. "Your orator cannot say whether or not said Moores and Handley organized said corporation for the purpose of evading the force and effect of their said agreement with your orator, but does say and charge that the effect of their doing so would be to perpetrate a fraud on your orator, if they should be allowed to handle plow-blades and plow-stocks; that the defendant's business, as now conducted, is identically the same as that conducted by the said Moores and Handley, is conducted by the same persons, and in substantially the same manner as before, and that the only change in fact has been in the name of the concern. And your orator alleges that said Moores and Handley, in making said agreement with your orator, thereby meant and intended, and such was your orator's intention, that they would not again engage in selling or handling plow-blades or plow-stocks in connection with their said business in the city of Birmingham, so long as your orator was engaged in the like business."

The defendant answered the bill, admitting its allegations as to the contract between the complainant and Moore, Moore & Handley, and the nature of the business carried on by the several parties; denying that it assumed, or in any manner became liable for, the obligations of said partnership, or of its individual partners, or that it acquired any interest in the outstanding notes and accounts due to said partnership,

or the real estate owned by the partners, which was more than sufficient to pay all their outstanding debts and liabilities; alleging that Wimberly owned a one-fourth interest in the corporation at its organization, and for some time acted as its treasurer, but admitting that the Moores and Handley had since bought out his interest insisting that said contract was illegal and void, because in restraint of trade, and, if valid, was not binding on the defendant and demurring to the bill for want of equity.

After answer filed, the defendant submitted a motion to dissolve the temporary injunction, and to dismiss the bill, and this appeal is taken from the decree of the chancellor overruling and refusing these motions.

MCCLELLAN, J.<sup>2</sup> The equity of the bill, so far as the injunction is concerned, and the sufficiency of those of its allegations which are not denied by the answer to sustain the injunction, depend primarily on two questions: First, whether the contract relied on is void, as being in unreasonable restraint of trade; and, second, whether a negative undertaking entered into by persons who subsequently organize, and for the time constitute, a corporation for the prosecution of the business with respect to which the contract was made, can be enforced by injunction against the corporation. \* \* \*

2. The general doctrine is well established, and obtains both at law and in equity, that a corporation is a distinct entity, to be considered separate and apart from the individuals who compose it, and is not to be affected by the personal rights, obligations and transactions of its stockholders; and this, whether said rights accrued, or obligations were incurred, before or subsequent to incorporation. 1 Mor. Priv. Corp., §§ 227-234, 547-549; Morrison v. Gold Mt. G. M. Co., 52 Cal. 309; Hawkins v. Mansfield G. M. Co., 52 Cal. 515; Gent v. M. & Mut. Insurance Co., 107 Ill. 658; Caledonian R. Co. v. Helensburgh, 2 Macg. 391; Penn Mat. Co. v. Hapgood, 141 Mass. 147, 7 N. E. 22.

There is a class of contracts, however, which are entered into between the promoters or prospectors of a contemplated corporation and third persons, on the faith of the corporation, intended to inure to its benefit, and which in point of fact do inure to its benefit, on which the corporation will be charged, even on the absence of an express promise to perform, or ratification on the part of the company after it is in esse; on "the familiar principle, that one who accepts the benefit of a contract, which another volunteers to perform in his name, and on his behalf, is bound to take the burden with the benefit." Redf. R. R. (5th Ed.) 18; Edwards v. Grand Junc. R., 1 M. & Cr. 650; Stanley v. Birkenhead R., 9 Sim. 264; Little Rock & F. S. R. Co. v. Perry, 37 Ark. 164; Perry v. Little Rock & F. S. R. Co., 44 Ark. 383; Bonumer v. Am. Spiral Co., 81 N. Y. 468.

And in those cases where "associates combine together to create a paper corporation, to cover a partnership or joint venture, and where

<sup>2</sup> A portion of the opinion is omitted.



the stockholders are partners in intention," and have resorted to the fiction of separate corporate entity to free themselves from individual obligations which had attached to them, with respect to the business they propose to carry on, prior to the organization of the company, courts of equity, when the ends of justice require it, will disregard and look beyond the fiction of corporate entity, and hold the corporation to a discharge of the liabilities resting on its members; and this may be done, although some of the shareholders had not originally incurred the obligation sought to be enforced, provided they had notice of it before entering the corporation, and participated in the effect to avoid it. *Davis Imp. Wrought Iron W. W. Co. v. Davis Wrought Iron W. Co.* (C. C.) 20 Fed. 700; *Beal v. Chase*, 31 Mich. 490, 495, 532.

The contract of *Moore, Moore & Handley*, sought to be enforced against the Moore and Handley Hardware Company, was not an undertaking between promoters of the company and third parties, nor made on the faith of the corporation, nor intended to inure to its benefit, nor did it inure, in point of fact, to the benefit of the corporation. It is not of that class of contracts which courts enforce against corporations, on the ground that they were made in the corporate name by anticipation, and that the corporation received and accepted the benefits resulting from them.

There is no allegation of fraud made against the corporation, or its shareholders, and the implication of the fraudulent effect of the corporate action complained of is denied. It is not shown that this is a mere "paper corporation," to cover a joint venture, in which the corporators are partners in intention, and have resorted to this form for the purpose of evading and avoiding obligations which they had taken upon themselves as individuals, or for the purpose of evading the promise relied on here. If these things had appeared in the case, we should not hesitate to hold the corporation answerable for the individual obligation. But, in the absence of fraud, "no authorities have gone the length of holding that any contract made with individuals, exclusively upon individual credit, will become the contract of any future corporation that may be formed, for the more convenient management and use of the benefits of it." *Little Rock & F. S. R. Co. Cases*, supra.

If the case of *Beal v. Chase*, supra, goes beyond this doctrine, we cannot indorse it. We do not think it does. In that case, the corporation had been formed for the purpose of violating a contract not to engage in a certain business. All the corporators were held to have participated in this purpose. The business was to be conducted by the corporation, in connection with the promisor in his individual capacity. He had an interest in it, both, individually and as the principal shareholder of the company; and the court enjoined the corporation, not generally, but from carrying on the business with or for the individual contracting party. To put the case at bar in line with that case, it would have to appear, not only that the corporators organized for the purpose, and with the intention of evading their contract, through the

separate entity of corporate existence, but also that they reserved an interest in the business distinct from their interests as stockholders. None of these facts are shown. The effect of allowing the injunction in this case to continue, would necessarily be to hold all future shareholders in the corporation to the performance of a contract which neither they nor the corporation had ever entered into, and of which they may not even have had notice. Such a result could only be justified on the ground of bad faith in the creation of the company. To thus hamper a bona fide corporation, would be inequitable, and have the effect of establishing a doctrine fraught with much danger to corporate rights, powers and property.

The allegations going to show a ratification, by the corporation, of this contract of Moore, Moore & Handley, are denied by the answer, and hence cannot be considered in passing on the decree overruling the motion to dissolve the injunction. Those allegations of the bill which are not denied, were not sufficient to authorize a continuance of the injunction, and the decree on that point was erroneous, and is reversed.

The contract relied on here is such a one as the respondent corporation could have made under its charter. It is, therefore, one which, being already in existence between complainant and the individuals composing the defendant company, the corporation had the power to ratify and adopt. The bill, in our judgment, sufficiently avers such ratification or adoption. These allegations give equity to the bill, and the decree overruling the demurrer is affirmed.

The cause will be remanded, with instructions to the chancellor to dissolve the injunction, unless the complainant amends its bill so as to entitle it to a continuance of the writ, under the principles we have announced. Reversed and remanded.

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CONTINENTAL TYRE & RUBBER CO., Limited,  
v. DAIMLER CO., Limited.

(Court of Appeal. [1915] 1 K. B. 893.)

LORD READING, C. J.<sup>3</sup> These two actions are brought for the purpose of determining whether during the war payment of a debt can be enforced by a company of which all the shareholders and directors are alien enemies. In the first action Scrutton, J., affirmed the order of the Master giving leave to sign final judgment under Order XIV. In the second, the action was tried before Lush, J., who decided in favour of the plaintiff company. The present appeals are against both judgments and by consent were heard together. They have been ably and elaborately argued and raise points of considerable importance.

The plaintiffs are a limited liability company incorporated under the

<sup>3</sup> The statement of facts and portions of the opinions of Reading, C. J., and Buckley, L. J., are omitted.



Companies Acts. They carry on business in London at the registered office of the company and have a number of agencies throughout the United Kingdom. The company was formed in 1905 with a capital of £10,000., increased in 1908 to £25,000., to trade in motor car tyres made in Germany by a company incorporated under German law. The German company formed a number of subsidiary companies in various parts of the world for the sale of these tyres. The plaintiff company was formed for the purpose of selling such tyres in the United Kingdom. At the date of the writ the German company held 23,398 shares in the plaintiff company, and the remaining shares (except one) are now held by subjects of the German Empire residing in Germany. The one share is registered in the name of the secretary of the company, who was born in Germany, resided in London, and in January, 1910, became a naturalized subject of the Crown. The directors are subjects of the German Empire and are resident in Germany. The business is managed according to the evidence of the secretary by two managers and himself, all three being resident in this country.

In the first case the plaintiff company is the drawer and holder of bills accepted by the defendants for goods supplied before the declaration of war. The bills matured for payment and were presented after the declaration of war. In the second case the plaintiffs' claim is for a balance of account for goods supplied before the war. It is admitted by both defendants (except as to a small amount in the second action) that the goods have been delivered and that payment for them is due, but both defendants have resisted payment on the ground that in the circumstances above stated the plaintiff company was not entitled to receive and could not enforce payment of the debt. The appellants contend that the plaintiff company must be regarded as an alien enemy notwithstanding that it is a limited liability company, and that as commercial intercourse between persons under the protection of the Crown and persons who are alien enemies is illegal, payment to the plaintiff company must be illegal. They further contend that the Court should look at the substance and not the technicalities of the matter. If the plaintiff company is to be regarded as an alien enemy, the payment would be illegal under the common law and also under paragraph 5, sub-paragraph 1, of the Royal Proclamation relating to Trading with the Enemy issued on September 9, 1914, which forbids payment to or for the benefit of an alien enemy, and is a Proclamation in force within section 1, sub-sec. 2, of the Trading with the Enemy Act, 1914. The appellants further contend that the directors, having become alien enemies at the outbreak of the war, ceased to be directors of the company, and that as no other directors had been appointed no authority had been or could be given to bring these actions. These contentions require careful consideration.

It cannot be disputed that the plaintiff company is an entity created by statute. It is a company incorporated under the Companies Acts and therefore is a thing brought into existence by virtue of statutory

enactment. At the outbreak of war it was carrying on business in the United Kingdom; it had contracted to supply goods, it delivered them, and until the outbreak of the war it was admittedly entitled to receive payment at the due dates. Has the character of the company changed because on the outbreak of war all the shareholders and directors resided in an enemy country and therefore became alien enemies? Admittedly it was an English company before the war. An English company cannot by reason of these facts cease to be an English company. It remains an English company regardless of the residence of its shareholders or directors either before or after the declaration of war. Indeed it was not argued by Mr. Gore-Browne that the company ceased to be entity created under English law, but it was argued that the law in time of war and in reference to trading with the enemy should sweep aside this "technicality" as the entity was described and should treat the company not as an English company but as a German company and therefore as an alien enemy. If the creation and existence of the company could be treated as a mere technicality, there would be considerable force in this argument. It is undoubtedly the policy of the law as administered in our courts of justice to regard substance and to disregard form. Justice should not be hindered by mere technicality, but substance must not be treated as form or swept aside as technicality because that course might appear convenient in a particular case. The fallacy of the appellants' contention lies in the suggestion that the entity created by statute is or can be treated during the war as a mere form or technicality by reason of the enemy character of its shareholders and directors. A company formed and registered under the Companies Acts has a real existence with rights and liabilities as a separate legal entity. It is a different person altogether from the subscribers to the memorandum or the shareholders on the register (per Lord Macnaghten in *Salomon v. Salomon & Co.*, [1897] A. C. 22, at p. 51). It cannot be technically an English company and substantially a German company except by the use of inaccurate and misleading language. Once it is validly constituted as an English company it is an artificial creation of the Legislature and it retains its existence for all intents and purposes. It is a living thing with a separate existence which cannot be swept aside as a technicality. It is not a mere name or mask or cloak or device to conceal the identity of persons and it is not suggested that the company was formed for any dishonest or fraudulent purpose. It is a legal body clothed with the form prescribed by the Legislature.

In determining whether a company is an English or foreign corporation no inquiry is made into the share register for the purpose of ascertaining whether the members of the company are English or foreign. Once a corporation has been created in accordance with the requirements of the law it is an English company notwithstanding that all its shareholders may be foreign. Just as a foreign corporation does not become British and cease to be foreign if all its members are subjects

of the British Crown (per Lord Macnaghten, Lord Brampton, and Lord Lindley in *Janson v. Driefonstein Consolidated Mines*, [1902] A. C. 484, at pp. 497, 501, and 505). For the appellants' contention to succeed payment to the company must be treated as payment to the shareholders of the company, but a debt due to a company is not a debt due to all or any of its shareholders: *Salomon v. Salomon & Co.*, [1897] A. C. 22. The company and the company alone is the creditor entitled to enforce payment of the debt and empowered to give to the debtor a good and valid discharge. Once this conclusion is reached it follows that payment to the plaintiff company is not payment to the alien enemy shareholders or for their benefit.

The same result is arrived at under paragraph 3 of the above mentioned Proclamation. It defines "enemy" in paragraph 3: "The expression 'enemy' in this Proclamation means any person or body of persons of whatever nationality resident or carrying on business in the enemy country, but does not include persons of enemy nationality who are neither resident nor carrying on business in the enemy country. In the case of incorporated bodies, enemy character attaches only to those incorporated in an enemy country."

Therefore although payment is forbidden "to or for the benefit of an enemy" this prohibition does not apply when payment is made to a company incorporated in this country. Under this Proclamation it appears clear that the test of residence or place of carrying on business to determine whether an incorporated body was enemy or not is not to be applied. The company only becomes enemy if incorporated in the enemy country, and as the plaintiff company was not incorporated in the enemy country, enemy character does not attach to it. Further it is provided by section 1, sub-sec. 2, of the 'Trading with the Enemy Act, 1914,' that any transaction permitted by or under any Proclamation issued by His Majesty dealing with trading with the enemy shall not be deemed to be trading with the enemy. As by the Proclamation enemy character attaches only to those incorporated in a foreign country it follows that payment to a company incorporated in this country is not only not forbidden, but is in our opinion impliedly permitted. (Both in the Proclamation and the statutes relating to trading with the enemy the adjective "alien" is not used, doubtless because it was thought superfluous when once "enemy" had been defined.)

It must, however, be clearly understood that any person who on behalf of the plaintiff company paid money to shareholders resident or carrying on business in Germany or to a company incorporated in Germany would be acting in defiance of the law, and none the less because payment is made in the name of the company.

That would be a criminal offence and would be within the express prohibition of paragraph 5, sub-paragraph 1, as defined by paragraph 3. The plaintiff company has never claimed any such right and has explicitly disclaimed any such intention. According to the evidence money received is paid into the plaintiffs' banking account and £9000.



per month is drawn out and paid into another account of the plaintiff company at the bank for the purpose of meeting expenses and establishment charges throughout the United Kingdom; the remainder of the money received is left to accumulate in the bank.

It is to be observed that if payment to a company would be payment "to or for the benefit of an enemy" because all the shareholders are enemies and because payment to the company must be regarded as payment to the shareholders it would seem to follow that payment of a debt to a company which had some enemy shareholders would equally come within the forbidden area. The appellants' answer is that their contention extends at most to those companies in which enemy shareholders are in the majority and in such circumstances as would lead to the conclusion of fact that substantially the company is enemy. Further if this contention were rejected it is urged that when as in the present case all the shareholders and directors are enemies there is no room for doubt as to the fact and a decision in the appellants' favour could be confined to the special facts. There does not appear to be any logical ground for these distinctions. If it were permissible to look behind the existence of the entity and to regard the character of the individual shareholders in order to determine whether or not the payment is "to or for the benefit of an enemy" the suggested line of demarcation would be wholly arbitrary. If payment to a company with a majority of enemy shareholders is to be regarded as payment to an enemy company, what is the position of the other shareholders? Can it be suggested that the minority consisting of British or neutral shareholders cease to be shareholders in an English company and become members of an enemy corporation?

There is no judicial authority for the proposition of the appellants and indeed there is a weight of judicial opinion against it. See *Salomon v. Salomon & Co.*, [1897] A. C. 22, and *Janson v. Driefonstein Consolidated Mines*, [1902] A. C. 484. *Gramophone & Typewriter v. Stanley*, [1908] 2 K. B. 89, is a recent instance of the refusal of the court to treat the entity of a company as a mere form or technicality. The Commissioners of Inland Revenue sought to make the Gramophone Company, which was an English company, liable to pay income tax in respect of profits made by a German company in which the English company held shares. None of such profits had been received by the English company in this country, but it was sought to treat the profits of the German company for the purpose of income tax as if they were the profits of the English company. The Court of Appeal was of opinion that the business of the German company had not become the business of the English company. Notwithstanding that the English company held all the shares in the German company, the English company could not be treated as having any right to the undistributed profits of the German company. A fortiori it could not have any right to the payment of a debt due to the German company. See also *Kodak v. Clark*, [1902] 2 K. B. 450; *Id.*, [1903] 1 K. B. 505.

The argument of the appellants that, although the plaintiff company was an English company in times of peace, it could not be so regarded in time of war was further supported by Mr. Leslie Scott on the ground that the plaintiff company could not be regarded as a subject of the Crown. He said the company could not be a subject, it had no mind, it could not be loyal or disloyal to the State. He urged that alone the character of the shareholders must determine whose subject the plaintiff company is, and that when all the shareholders are enemy the plaintiff company is enemy. This point was discussed in *Janson v. Driefonstein Consolidated Mines*, [1902] A. C. 484. The litigation arose out of the South African war. The respondent corporation was formed and registered in the Transvaal Republic; most of the shareholders were resident outside the Republic, and were not subjects of it. The appellant, an underwriter and a British subject, objected that the corporation was alien enemy and could not sue. It was argued for the respondents that the corporation should not be regarded as subject to the laws of the Transvaal and as alien enemy. None of their Lordships favoured that view. Some of their Lordships assumed for the purpose of the case, but did not decide, that the company remained an alien enemy notwithstanding that most of the shareholders were not alien enemies (see Lord Halsbury, p. 490, Lord Macnaghten, p. 497, and possibly Lord Davey only assumed it, p. 498). Lord Lindley (p. 505) was of opinion that the company must be regarded as resident and carrying on business in the Transvaal and subject to the laws of the country, and he added: "When war broke out the company became an alien enemy of this country: see the American case of *Society for the Propagation of the Gospel v. Wheeler*, 2 Gallison (U. S.) 105. If it becomes material to attribute nationality to the company it would, in my opinion, be correct to say that the company was a Transvaal company and a subject to the Transvaal Government, although almost all its shareholders were foreigners resident elsewhere and subject of other countries." Lord Brampton, at p. 501, said: "The company clearly must be treated as a subject of the Republic, notwithstanding the nationality of its shareholders." These opinions are not to be taken as part of the actual decision, nevertheless they are opinions of great weight. In *Daniel v. The Award of the Commissioners for Liquidating British Claims on France*, 2 Knapp, P. C. 23, and in *Long v. The Same*, 2 Knapp, P. C. 51, it was held by the Privy Council that a corporation of British subjects existing in foreign country and under control of a foreign Government must be considered as a foreign corporation and was, therefore, not entitled to claim compensation under a treaty giving this right to British subjects. The corporation was the subject of the foreign State, and not of the British Crown. Even in reference to the ownership of a ship it was held in *The Queen on the Prosecution of the Pacific Steam Navigation Company v. Arnaud and Powell* (1846) 16 L. J. Q. B. 50, that, notwithstanding that some of the

members of the corporation were not British subjects but foreigners, the British corporation was the sole owner of the ship and a British subject. None of these authorities lend support to the appellants' argument they tend rather to assist the plaintiff's case.

There remains, however, the case decided in 1809, *Bank of the United States v. Deveaux*, 5 Cranch, 61, upon which much reliance was placed by Mr. Leslie Scott. The Supreme Court of the United States there decided that the Court could look beyond the corporate name and notice the character of the individuals who composed the corporation and treat them substantially as parties to the controversy. The question at issue arose from a peculiarity of the Constitution of the United States. The States Courts alone have jurisdiction to try all civil actions except in certain cases reserved by the Constitution and the Judiciary Law to the Federal Courts. One of these reserved cases is where a citizen of one State sues a citizen of another. A suit having been brought in the Federal Court in the corporate name of the bank, it was held by the Supreme Court that a corporate aggregate cannot in its corporate capacity be a citizen and, therefore, had no right of access to the Federal Court, though it was incorporated in and by one State and was suing the citizen of another State. However, Marshall, C. J., who delivered the opinion of the court, held that, although the corporate could not be a citizen, the Court could look behind the corporate name to ascertain the individuals composing it, so as to determine whether they were citizens of one State suing the citizens of another. The learned Chief Justice based his judgment upon *City of London v. Wood* (1701) 12 Mod. 669, which he treated as an authority for his decision that the court could look behind the corporate name. Upon an examination of that case, and notwithstanding the high authority of the learned Chief Justice, it does not support so sweeping a proposition. It was a case of a very special character. An action was brought by the Mayor and Commonalty of the City of London in the Court of the Mayor and Alderman of London. Objection was taken that the Mayor, who was the head of the City, without whom the City had no ability or capacity to sue, was also the very person before whom the action was brought for trial. The Court of King's Bench naturally shrank from upholding a judgment given under such circumstances, and held that the objection was fatal, upon the principle that a judge must not be an interested party in the suit before him. A person cannot be both party and judge in the same suit. The familiar instance is that of a judge who is a shareholder in a railway company sued for damages. It is the judge's duty to declare his interest to the parties, and unless they agree to waive any objection he cannot try the case. The absence of such declaration and assent of the parties is the explanation of this case. It is to be observed that in the decisions of our Courts this case has not been relied upon, and certainly has not been followed, as an authority for any such proposition as was argued before us.



Since the argument an examination of American authorities has disclosed that the case of *Bank of the United States v. Deveaux*, 5 Cranch, 61, has not since its decision found favour in the Supreme Court of the United States. In 1844, in the case of *Louisville Railroad Co. v. Letson* (1844) 2 Howard, 497, at p. 555, the Supreme Court thought that that case had gone too far and held that "a corporation created by a State to perform its functions under the authority of that State and only suable there though it may have members out of the State, seems to us to be a person, though an artificial one, inhabiting and belonging to that State, and therefore entitled, for the purpose of suing and being sued, to be deemed a citizen of that State. We remark too that the cases of *Strawbridge and Curtis* and the *Bank and Deveaux* have never been satisfactory to the Bar, and that they were not, especially the last, entirely satisfactory to the Court that made them. They have been followed always most reluctantly and with dissatisfaction. By no one was the correctness of them more questioned than by the late Chief Justice who gave them. It is within the knowledge of several of us that he repeatedly expressed regret that those decisions had been made, adding, whenever the subject was mentioned, that if the point of jurisdiction was an original one, the conclusion would be different. We think we may safely assert that a majority of the members of this Court have at all times partaken of the same regret, and that whenever a case has occurred on the circuit involving the application of the case of the *Bank and Deveaux* it was yielded to, because the decision had been made, and not because it was thought to be right." In 1895, in the case of *St. Louis & San Francisco Railway v. James*, 161 U. S. 545, the Supreme Court again approved the view that the *Bank and Deveaux* had gone too far, and held that there was an indisputable legal presumption that a corporation is composed of citizens of the State which created it and that presumption of citizenship is one of law not to be defeated by evidence to the contrary. Although not binding upon us, the decision of Marshall, C. J., and of the Supreme Court is entitled to our very high respect, and this has caused us to give our most careful consideration to this judgment. It is satisfactory to find in the result that the law of the United States is that the corporation is regarded as a citizen of the State in which it is created, and is, therefore, not in conflict but in harmony with our law.

It was further contended on behalf of the appellants that such technicalities have not been allowed to bind the decisions of the Prize Court, and the case of *The Tommi*, [1914] P. 251, was cited. The President there said: "The decision as to when property passes is often very difficult when dealing with municipal law. It depends upon fine technicalities; but the like technicalities have not been allowed to bind the decisions of the Prize Courts when transfers of property are attempted when war is actual or imminent. They have been treated as gossamer, which can be wiped entirely aside, because the Prize Court regards the essential qualities of a transaction, and tries to arrive at

the realities of the case. \* \* \*

"It is sufficient for the purpose of this case to say that in this Court we are administering the municipal law and must follow it. In the later case of *The Roumanian*, [1915] P. 26, decided on December 7, 1914, a point more closely resembling that in these appeals came before the President. It was a claim to resist condemnation of the cargo ex the vessel on the ground that the owner of the cargo, the *Europäische Petroleum Union*, though a company incorporated at Bremen under the laws of the Empire of Germany, was in substance and reality a company owned and controlled by companies or firms in allied or neutral countries. In fact only 10 per cent. of the shareholders of the company were alien enemies, the other 90 per cent. being allies or neutrals. The learned President in giving judgment says: "Neutral bodies and subjects are shareholders to a considerable extent in this company. It is a corporate body duly incorporated under the laws of Germany and as such entered an appearance in these proceedings. There was some discussion in argument as to its constitution, but it was really denied that it was a German company. It clearly is." The owner of the cargo of oil being therefore an enemy company, the decree for condemnation was made and the German company's claim failed. The decision in *The Roumanian*, [1915] P. 26, shows that the character of the entity and not of the shareholders was regarded. That is in accordance with the municipal law and is unfavourable to the appellants' argument before us. \* \* \*

In our opinion both appeals must be dismissed with costs. This is the judgment of all members of the Court except BUCKLEY, L. J. The late KENNEDY, L. J., had read the judgment I have just delivered and approved it before his death.

BUCKLEY, L. J. I regret that I am unable to concur in the judgment just delivered. I regard the question as so momentous that I make no apology for stating as clearly as I am able my reasons for arriving at a contrary conclusion.

The artificial legal entity created by incorporation under the Companies Acts is a legal person existing apart from its corporators. This proposition is true without exception, and nothing in this judgment questions the proposition in any way. If there be twelve corporators one of them is not a twelfth or any part of the corporation. The total number of twelve do not in the aggregate constitute the corporation. On the other hand the corporation cannot exist without corporators. If there are no corporators there can be no corporation. Corporators are essential to the existence of but form no part of the corporation.

The artificial legal person called the corporation has no physical existence. It exists only in contemplation of law. It has neither body, parts, nor passions. It cannot wear weapons nor serve in the wars. It can be neither loyal nor disloyal. It cannot compass treason. It can be neither friend nor enemy. Apart from its corporators it can have **neither** thoughts, wishes, nor intentions, for it has no mind other than



the minds of the corporators. These considerations seem to me essential to bear in mind in determining the present case.

The corporation if it be a British corporation stands in the same position for most purposes as a British subject. For instance as regards rights of ownership of property and the right to protection and assistance by the law. But while it stands for most purposes in the position of a British subject it cannot, I think, be correctly described as a British subject. A subject must, I conceive, be one who can owe and pay allegiance to the King, who can serve the King physically, for instance if he be a male by wearing weapons and serving in the wars, who has a mind and can be either loyal or disloyal to the King. None of these can be predicated of the abstract legal entity. It has no existence at all except in contemplation of law. If these propositions be true, as I think they are, they seem to me to go to the root of the question which has in this case to be determined.

This corporation is one which as a corporation certainly has in law an independent legal existence and that legal person is British. But on the other hand all its directors are Germans resident in Germany. The holders of all its 25,000 shares except one share are German resident in Germany. The artificial legal thing is British, resident in England. But all its corporators who can have thoughts, wishes, or intentions are German resident in Germany.

The question for determination is whether when all the natural persons who express and give effect to their wishes through the corporation as a legal abstraction are Germans resident in Germany the corporation can sue in this country because those persons who could not sue are as matter of law absorbed in a separate legal person which is British and which (regarding the corporation as a legal person existing apart from and irrespective of its corporators) can sue.

The contractual relations constituted by membership in a corporation under the Companies Acts are singular. The relation between each corporator and the corporation is a contractual relation governed by the statute, involving rights within the corporation, rights against the corporation, and liabilities towards the corporation. Where the corporator is an alien enemy these relations may be vitally affected by a state of war. The motive power of the corporation (which in itself apart from its corporators, or its agents—appointed and authorized through acts done by the corporators—has no life and no power of action) may become paralysed and suspended by the existence of war in a case where every corporator is as an alien enemy under disability as such.

Suppose the case of a corporation sole. A private company may be formed consisting of only two persons. It was much debated a few years ago whether the law should not be so altered as to allow a sole person to incorporate himself as a company with limited liability. Suppose that were the law, and an individual German resident in Ger-

many, an alien enemy in fact, became incorporated here as a British company, could it be seriously contended that in time of war that an alien enemy because he had acquired a legal corporate name and had an artificial legal existence in this country was consequently for the present purpose not an alien enemy? Does it make any difference that there must be two persons, or again does it make a difference that the number is seven or ten? The number of corporators in the present company is six.

The immense importance of the question whether it is impossible for any purpose to look behind the corporation at the person of the corporator may be illustrated by the case of merchant shipping. Under section 1 (d) of the Merchant Shipping Act, 1894, ships owned by a shipping company incorporated in this country are British ships. The individual members of that body corporate may be aliens. If the personality of the corporators can for no purpose be regarded there is nothing to prevent alien enemies from owning and sailing British ships under the British flag. If this judgment be (as having regard to the judgment of the other members of the Court I must assume that it is) wrong, the matter is one which calls urgently for legislation.

The proposition that an alien enemy cannot sue rests, I conceive, upon the proposition that such an one cannot approach the King, has no resort to the King, and cannot invoke the assistance of the King. The Court is the King's Court. The alien enemy cannot come into that Court or have the assistance of that Court because the Court is for judicial purposes the King sitting in his Court and the alien enemy cannot approach him. Take the assumed case of the sole person incorporated as I have supposed; can that sole person be entitled to access to the King and assistance from the King because in contemplation of law he is entitled to clothe and has clothed himself in a British dress and notionally but not in fact is British? Take the case of two Germans who had formed a private company; can they approach the King? Take the present case of six Germans; can they approach the King? To say that they can because it is not they but the British corporation which approaches the King seems to me to be unsound. The proposition that it is the British corporation and not the corporators which as matter of legal intendment comes into Court is true, but for the relevant purpose it is not true. The artificial legal entity has no independent power of motion. It is moved by the corporators. It is the German corporator who, under the corporate name but still German for the relevant purpose of friendliness or enmity, is the person who comes. He is German in fact although British in form.

The question is not wholly without authority which may be a guide. In *City of London v. Wood*, 12 Mod. 669, the City of London brought a suit against Wood by their corporate name in the Mayor's Court. Objection was taken that the Court had no jurisdiction by reason of the fact that the Court was held before the Mayor and Alderman and the action brought in the names of the Mayor and Commonalty and

that it is against all law that the same person should be party and judge in the same cause. The objection rested therefore upon the character of the individuals who were members of the Corporation. The judges were unanimous in holding that they could look beyond the corporate name and notice the character of the individual. In *Bank of the United States v. Deveaux*, 5 Cranch, 61, the principle of that case was followed in the United States in the case of a suit brought by a corporation aggregate composed of citizens of one State against the citizens of another State in the Circuit Court of the United States. The jurisdiction of that Court was limited to controversies between citizens of different States. The Court affirmed (see p. 86) that the artificial legal entity, the corporation aggregate, was not a citizen and could not sue unless the rights of the members in this respect could be exercised in their corporate name, and that the Court had consequently no jurisdiction unless it could regard the rights of the members in the corporation, for they were citizens. The view the Court took was (see p. 91) that the controversy was substantially between aliens suing by a corporate name and a citizen; or between citizens of one State suing a corporate name and those of another State. "That name," said Marshall, C. J., at p. 87 (meaning the corporation by the corporate name), "cannot be an alien or a citizen; but the persons whom it represents may be the one or the other; and the controversy is, in fact and in law, between those persons suing in their corporate character, by their corporate name, for a corporate right, and the individual against whom the suit may be instituted." The Court accordingly upheld the jurisdiction. Referring to this case, Story, J., in giving judgment in *Society for the Propagation of the Gospel v. Wheeler*, 2 Gallison, 105, at p. 133, said: "But in the character of its members, as aliens, we have incontestable authority to enforce the corporate rights; and it has been solemnly settled by the Supreme Court, that for this purpose the Court will go behind the corporate name, and see who are the parties really interested. And if, for this purpose, the Court will ascertain who the corporators are, it seems to follow, that the character of the corporators may be averred, not only to sustain, but also to bar, an action brought in the name of the corporation. It might therefore have been pleaded in this case, even if the corporation had been established in a neutral country, that all its members were alien enemies; and upon such a plea, with proper averments, it would have deserved great consideration, whether it was not, *pendente bello*, an effectual bar." In my opinion the principles laid down in those cases are correct, and none the less because they have, as the Lord Chief Justice has pointed out, been subsequently observed upon in the United States. \* \* \*

For the above reasons I am of opinion that the Continental Tyre Company stand for the present purpose in the position of alien enemies, for that, to use the language of *Bank of the United States v. Deveaux*, 5 Cranch, at p. 91, the action is by "aliens suing by a corporate name."



I therefore think that these appeals should be allowed. The right form of order I think would be to set aside the service of the writ and to order the plaintiffs to pay the costs of the action.

Appeals dismissed.

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## II. The Corporation as a Collection of Individuals <sup>4</sup>

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### PEOPLE v. NORTH RIVER SUGAR REFINING CO.

(Court of Appeals of New York, 1890. 121 N. Y. 582, 24 N. E. 834, 9 L. R. A. 33, 18 Am. St. Rep. 843.)

Appeal from judgment of the general term of the Supreme Court in the first judicial department, entered upon an order made November 7, 1889, which affirmed a judgment in favor of plaintiff entered upon a verdict directed by the trial court, and affirmed an order denying a motion for a new trial.

This action was brought by the attorney-general to have the defendant "dissolved, its charter vacated and its corporate existence annulled." <sup>5</sup> \* \* \*

FINCH, J. The judgment sought against the defendant is one of corporate death. The state, which created, asks to destroy; and the penalty invoked represents the extreme rigor of the law. Its infliction must rest upon grave cause, and be warranted by material misconduct. The life of a corporation is indeed less than that of the humblest citizen, and yet it envelopes great accumulations of property, moves and carries in large volume the business and enterprise of the people, and may not be destroyed without clear and abundant reason. That would be true even if the legislature should debate the destruction of the corporate life by a repeal of the corporate charter; but is beyond dispute where the state summons the offender before its judicial tribunals, and submits its complaint to their judgment and review. By that process it assumes the burden of establishing the charges which it has made, and must show us warrant in the facts for the relief which it seeks.

Two of the charges preferred in the complaint have dropped out of sight. They were of little importance, and have been prudently dismissed from the inquiry for that reason; and we are left to consider the one grave and serious accusation to which alone the proofs and argument have been directed. That accusation is adequate to the purpose for which it was framed, but upon two conditions, which dictate the line of inquiry and limit the area of discussion. It appears to be settled that the state as prosecutor must show on the

<sup>4</sup> For discussion of principles, see Clark on Corp. (3d Ed.) §§ 1-3.

<sup>5</sup> The statement of facts is abridged.

part of the corporation accused some sin against the law of its being which has produced, or tends to produce injury to the public. The transgression must not be merely formal or incidental, but material and serious; and such as to harm or menace the public welfare. For the state does not concern itself with the quarrels of private litigants. It furnishes for them sufficient courts and remedies, but intervenes as a party only where some public interest requires its action. Corporations may, and often do, exceed their authority where only private rights are affected. When these are adjusted, all mischief ends and all harm is averted. But where the transgression has a wider scope and threatens the welfare of the people, they may summon the offender to answer for the abuse of its franchise or the violation of its corporate duty. The Code of Civil Procedure authorizes an action for that purpose when the corporation has "violated any provision of the law whereby it has forfeited its charter or become liable to be dissolved by the abuse of its powers." In *Thompson v. People*, 23 Wend. 583, the ground of forfeiture was tersely described as "some misdemeanor in the trust injurious to the public;" and as recently as the case of *Leslie v. Lorillard*, 110 N. Y. 531, 18 N. E. 363, 1 L. R. A. 456, we said, "In the granting of charters the legislature is presumed to have had in view the public interest; and public policy is concerned in the restriction of corporations within chartered limits; and a departure therefrom, is only deemed excusable when it cannot result in prejudice to the public."

Two questions, therefore, open before us: first, has the defendant corporation exceeded or abused its powers, and second, does that excess or abuse threaten or harm the public welfare.

The first question requires us to ascertain what the defendant corporation has done in violation of its duty, or omitted to do in performance of its duty. We find disclosed by the proof that it has become an integral part and constituent element of a combination which possesses over it an absolute control, which has absorbed most of its corporate functions, and dictates the extent and manner and terms of its entire business activity. Into that combination, which drew into its control sixteen other corporations engaged in the refining of sugar, the defendant has gone, in some manner and by some process, for as an unquestionable truth we find it there. All its stock has been transferred to the central association of eleven individuals denominated a "Board;" in exchange it has taken and distributed to its own stockholders certificates of the board carrying a proportionate interest in what it describes as its capital stock; the new directors of the defendant corporation have been chosen by the board, made eligible by its gift of single shares, and liable to removal under the terms of their appointment at any moment of independent action. It has lost the power to make a dividend, and is compelled to pay over its net earnings to the master whose servant it has be-

come. Under the orders of that master it has ceased to refine sugar, and by so much, has lessened the supply upon the market. It cannot stir unless the master approves, and yet is entitled to receive from the earnings of the other refineries, massed as profits in the treasury of the board, its proportionate share for division among its own stockholders holding the substituted certificates. In return for this advantage it has become liable to be mortgaged, not for its own corporate benefit alone, but to supply with funds the controlling board when reaching out for other and coveted refineries. No one can look these facts fairly in the face without being compelled to say that the defendant is in the combination and in to stay. Indeed, so much is with great frankness admitted on the part of the appellant. Its counsel concedes that the stock was transferred "to the board mentioned in the agreement and on the terms and for the purposes mentioned in the agreement; and that this action effectually lodged the control of the defendant company, so far as such control can be secured by the voting power, in that board."

But that truth does not alone solve the problem presented. We are yet to ascertain whether the corporation became the subordinate and servant of the board by its own voluntary action, or the will and power of others than itself; by force of a contract to which it was in reality a party, or as the simple consequence of a change of owners; by its fault or its misfortune; by a sale or by a trust. For, if it has done nothing, if what has happened, and all that has happened, is ascertained to be that the stockholders of the defendant one or many, sold absolutely to the eleven men who constituted the board their entire stock, and the latter, by force of their proprietorship and as owners, have merely chosen directors in their own interest, and are only managing their property in their own way as any absolute owners may; if that is the truth, and the entire and exact truth, it is difficult to see wherein the corporation has sinned, or what it has done beyond merely omitting for a time to carry on its business. That is the theory upon which the appellant stands, and which it submits to our examination.

On the other hand it is contended that there never was a sale, but a trust constituted by mutual agreement; that they who agreed were the whole body of stockholders in each corporation necessarily representing and binding the corporation itself; that they transferred their shares to the board upon the trusts declared in the deed; that the certificates issued by the board were the formal declaration of the trust; that the corporate stockholders parted with the legal title of their stock to the chosen trustees with the power to vote upon it, but retained, nevertheless, its beneficial ownership through the operation of these certificates; and so the corporations entered into a partnership with each other, vesting the partnership power in a board of control.



I have brought these two theories face to face where they may confront each other, because, when a choice is made between them, we have gone a long distance toward the end of the controversy.

In making that choice we must necessarily analyze and construe the deed or contract which formed the terms of the combination, and which not only dictated its character, but brought it into existence. That contract, on the theory of a sale, is an unexpected and unaccountable document. A sale presumes vendors on the one side and vendees on the other, each having life and existence and the power and ability to contract. Here there was no joint stock association existing or organized until the vendors themselves created it, and they were obliged to construct their vendee in the very act of transfer. A contract of sale implies some negotiations between buyer and seller, each consulting his own interest and acting independently and of his free choice. Here there was no negotiation with the board, but the vendors having created their vendee, themselves alone dictated the terms on which they should sell and it should buy. The selling stockholder explicitly swears that the board had nothing whatever to do with fixing the price. In a contract of sale covering property valued at some fifty millions of dollars and containing a patent statement of the terms of the trade, we should naturally expect that at least the buyer would give it his signature and bind himself to the purchase. This contract of sale is not signed by the vendees at all, and their assent is left to be supplied by inference from their action. In an ordinary sale the vendee becomes owner, and has the rights of an owner and may do what he pleases with his own; but this contract tells the owners what they shall do with the property bought, and how they shall hold it, and inferentially at least forbids its further sale or transfer. As a general rule the vendor fixes the value or price of the property which he sells, or sometimes submits the question to disinterested appraisers, but this contract of sale generously allows the value of the personal property, separate from the plant, to be appraised and fixed by five persons, all of whom are themselves among the purchasers.

These are general considerations which make one hesitate over the theory of a sale as distinguished from a trust, but the doubt increases as we come closer to the details of the agreement and scrutinize its exact terms.

It is observable that the selected transferee of the stock of the corporations was denominated simply by a "board." That implied agency, a committee of managers, official servants charged with executive duties and acting for any in the interest of others. The idea of a joint-stock association, capable of buying and acting as purchaser, had not yet dawned. Explicitly the deed declares "the shares of the capital stock of the several corporations to be transferred to the names of the board as trustees, to be held by them and by their suc-

cessors as members of the board strictly as joint tenants." If beyond the inference of agency, suggested by the name and description of the board, more was needed to indicate the real aim and intention, it is supplied by the frank declaration that the transferees shall take as trustees, and hold in joint tenancy, which is the characteristic manner of a trust.

Other clauses in the instrument point significantly to the same construction. The purchase of stock in a corporation makes the buyer a stockholder. No such purchaser would think for a moment of requiring from the corporation a stipulation that he should have the rights of a stockholder, for those rights attach at once by force of his ownership. Yet we find in the document under examination, following the provision which requires the board to take as trustees, a clause entirely superfluous if a sale was meant, but a reasonable stipulation if a trust was intended, that "the board shall hold the stock transferred to it with all the rights and powers incident to stockholders in the several corporations." The clause carries with it a distinct suggestion that no absolute sale was intended, but a transfer in trust which might leave the assignors who became the beneficiaries some equitable right over the voting power, and to make sure of the vesting of that right in the trustees a specific and broad covenant was adopted adequate for all emergencies.

The owners of corporate stock, by force of their ownership, may put a mortgage upon the corporate property when the statute permits. Nobody doubts that, and no buyer would demand that permission of the seller. But the contract in question explicitly authorizes the board to raise money by mortgages upon the property of the corporations. It strikes one as odd to see an absolute purchaser requiring his vendor in the deed of conveyance to covenant that the grantee may be at liberty to incumber by mortgage his own property. The astute pen which framed the deed of association had a very different aim, and realized that trustees, holding for trust purposes, should have power to mortgage given them if that necessity was contemplated.

A vendor about to sell his property, and to a very large amount, naturally looks carefully to his pay. A merchant or manufacturer who should sell his wares to a corporation having no other capital than the exact property bought, and take his pay in the stock of such corporation would scarcely be deemed sane in business circles. The board organized by the refineries had a nominal capital of fifty millions, but not a single dollar of actual capital beyond the corporate shares transferred; and so the sellers, if indeed, they were such, got aliquot parts of their own property in payment for the transfer. If they sold it, they simply got it back under a new name and, as we shall see, heavily watered, and with its care and management entrusted to others, under an arrangement which might or might not add to its earning power.



If in truth, the board was meant to be anything more than a trustee or manager of the combined corporations, if it was contemplated that it should become and be a joint-stock association at all, it was put by the very articles of its creation under the most singular and oppressive restrictions. What shall we say of a joint-stock association without a dollar of actual capital, and yet, forbidden to incur the least debt or obligation? It was commanded that "no action be taken by the board which shall create liability by it or by its members." Without a dollar it could not borrow a dollar; without money it could incur no debt; its cash resources were to come from a sale of its own certificates reserved over and above those allotted, or from mortgages made by the separate corporations, and yet this curious creation, viewed as a joint-stock association, was able to induce the sale to it of twenty corporations. The stockholders with astonishing generosity sold and transferred to it all their stock, allowed it to pocket fifteen per cent. of its agreed value, and took aliquot parts of the remainder of their own property for their pay. It seems to me that the theory of an absolute sale involves us in difficulties and complications on almost every page of the deed or combination agreement, and that it is an after-thought framed under pressure and mismatching the entire tenor and terms of the instrument which it was invented to sustain. Indeed, I notice, among the briefs submitted to our study, a reprint of an article from a distinguished pen which traces the origin and history of economic combinations and monopolies, and ends with a determined defense of the one under review, but concedes it to be a trust, created by contract, and organized and existing as such.

The combination, therefore, framed by the deed was a trust; and, if created by the corporations, or in any respect the consequence or product of their action, some inevitable results would be certain to follow. But here we encounter the stronghold of the appellant's argument which is, that if the corporations are in some manner in the combination, they are there solely as the result of a contract other than their own; are there without corporate action on their part; and so are sufferers and not sinners. The reasoning leading to that result is so severely technical as to have suggested a justification almost reminding one of an apology. We are called upon to sever the corporation, the abstract legal entity, from the living and acting corporators; as it were, to separate in our thought the soul from the body, and admitting the sins of the latter to adjudge that the former remains pure. Let us first recall the facts in the order of their occurrence.

On the 22d day of April, 1887, there was a meeting of defendant's stockholders at which all the trustees were present. At that meeting the following preamble and resolutions were adopted by a unanimous vote:

"Whereas, It is contemplated that the several sugar refineries in New York and other cities shall consolidate their several refineries in one large concern or company; and

"Whereas, We deem it for the interest of the North River Sugar Refining Company to participate in the above said consolidation; therefore be it

"Resolved, That Peter Moller, Jr., George H. Moller and Gerd Martens be, and they are hereby, appointed a committee to make arrangements to perfect the said consolidation in behalf of the North River Sugar Refining Company with full power to act and to sign all contracts and agreements in the name of the said North River Sugar Refining Company, of whatever name or nature, concerning the said consolidation.

"Resolved, That we authorize the president and secretary of the North River Sugar Refining Company to sign all contracts, agreements and papers which the above-named committee may make in relation to the said consolidation."

In September following the secretary of the corporation added its signature to the deed. He tells us under oath, "I made that signature by virtue of authority from the stockholders and the board of officers of the North River Sugar Refining Company, the stockholders and trustees." It follows that the committee to whom authority was given to make the agreement, had made it. The stockholders by a unanimous vote decided to go into the proposed combination, and authorized their committee to agree on the terms. A trust of personal property may be created by parol. That the committee acted, that they contracted for their company upon the terms of the deed, is an inevitable inference from the action of the secretary, who swears that he signed by authority, and could have had none except the agreement of the committee. It was, therefore, actually made, and the official signature was but the evidence of the agreement entered into by them. Here was a deliberate corporate act, if stockholders and trustees united can ever perform one, attested by one of the two officers who were authorized to sign. At that moment the defendant company had become a party to the contract by the consent of everybody connected with the corporation, and by force of the agreement to that effect which the signature of the secretary shows had been made by the authorized agency.

But it is said the corporation repented and withdrew from the agreement. I do not stop to discuss the question whether they could revoke without the consent of the board, and their associates in the trust deed, for assuming that they could, I prefer to analyze their revocation and see the scope and range of their repentance. The corporation remained a contracting creator of the trust until November 4, 1887. By the deed, the trust took effect on October first of that year, so that the defendant in its full corporate character be-

came a party to it according to the terms of the deed, and remained bound by it for at least one month. But then there did come either repentance or fear. In November the stockholders again assembled and passed the resolution which is relied upon as a revocation. Its preamble recites a series of denials that the committee had made any agreement or that the president and secretary had signed any, and then, after declaring "it is deemed inexpedient at the present time to enter into any such consolidation," they revoked the powers conferred and the resolutions conferring them. That is to say, after the powers had been executed and put the corporation into the combination, and it had become a constituent element of the trust, those powers were revoked upon a false assertion that they remained executory and so their revocation could be effective. I say a false assertion, for we are not at liberty to believe that George H. Moller, who was secretary of the corporation and one of the very committee authorized to make the agreement of consolidation, signed the deed when he knew that the committee had not agreed, and so in violation of his duty and without authority, and then positively swore that he signed by authority of the stockholders and trustees. His act and his oath heavily outweigh the resolutions of repentance. Let us not fail to observe that no signature is withdrawn, no notice is served upon the board or the associates, no consent of theirs is asked or demanded, but the parties of one part to a contract come together and pass a resolution that they have not contracted and do not mean to, and rely upon that as releasing them from their obligation. All that they effectively did was to raise a question of veracity which must be decided against them upon the act and the oath of their own officer.

That repentance proved to be only a prelude to the exact sin claimed to have been avoided. On the 25th of November, 1887, which was just three weeks after the resolutions of revocation, the stockholders of the defendant company formally resolved to sell their capital stock for \$325,000 to John E. Searles, Jr. It is not unworthy of notice that the resolution to sell is prefaced by a recital that their secretary had signed a deed of consolidation "under the belief that he was authorized so to do," a matter which had nothing to do with the new agreement to sell unless the purpose of that agreement lay beneath the surface. The committee to deliver the stocks consisted of the same three persons who had originally been authorized to make the agreement of consolidation which had already been signed by Searles as treasurer of the Havemeyer Sugar Refining Company. The stock was delivered to him, the price paid to the stockholders, and so Searles became the one sole and only stockholder of the defendant company. He and the "legal entity" alone survived, and the latter apparently in a state of suspended animation. An effort was made to ascertain from what source the purchase-money came, but was not altogether successful. Searles did not furnish it. A certain committee of three



did, who were to transfer the stock to the board. Searles adds: "Those three gentlemen whom I have named as trustees of certain funds paid for the stock; fund received by them for mortgages and other matters connected with the organization. Q. What organization? A. The Sugar Refineries Company, the board." Well, the board got the stock from Searles, sole owner and sole stockholder, and gave in exchange certificates for \$700,000, or a little more than double the purchase-price, and which indicates the amount of water in the board's capital stock. From that, however, was deducted the fifteen per cent. retained by the combination. What Searles did with the certificates, we do not know, nor is it important to ascertain. We do know that new directors were chosen by the vote of the board; that Searles became president of the corporation; that its share of the regular dividend has been allotted to it for its certificate holders, and that it has wholly ceased to refine sugar. And thus its baptism in the pool of the board became complete and final.

And yet it is argued that the corporation, the legal entity, has done nothing; that Searles was guilty, but the corporate robe that enveloped him was innocent, and so he must be left to wear it undisturbed; that while all that was human and could act had sinned, yet the impalpable entity had not acted at all and must go free. I believe that the history of what occurred, as I have already described it, furnishes a sufficient answer, assuming that stockholders and trustees acting together can do a corporate act at all. There was corporate action in making the combination agreement which bound the defendant. The revocation of an executed authority left the contract standing. The corporation thus helped to make the trust and became an element of it. If there was anything imperfect in its action, the new stockholder and his associates waived the imperfection by acting upon the agreement of the corporation, and so confirming it in all particulars.

But the assumption underlying the view, I have expressed is itself contested, and a proposition asserted which denies the possibility of any corporate action, except by the trustees or directors acting formally as such; a proposition which, if sound, dominates the whole field of controversy, and, establishing that there has been no corporate action at all, effectually shuts out every question of illegality or public injury. I cannot admit that proposition. I think there may be actual corporate conduct which is not formal corporate action; and where that conduct is directed or produced by the whole body, both of officers and stockholders, by every living instrumentality which can possess and wield the corporate franchise, that conduct is of a corporate character, and if illegal and injurious may deserve and receive the penalty of dissolution. There always is, and there always must be, corporate conduct without formal corporate action where the thing challenged is an omission to act at all. A corporation organized in the public interest, with a view to the public welfare, and in the expectation of benefit to the community, which is the motive of the state's grant, may accept the

franchise and hold it in sullen silence, doing nothing, resolving nothing, furnishing no formal corporate action upon which the state can put its finger and say, this the corporation has done by the agency through which it is authorized to act. That is corporate conduct which the state may question and punish without searching for a formal corporate act. The directors of a corporation, its authorized and active agency, may see the stockholders perverting its normal purposes by handing it over, bound and helpless, to an irresponsible and foreign authority, and omit all action which they ought to take, offer no resistance, make no protest, but silently acquiesce as directors in the wrong which as stockholders they have themselves helped to commit. That again is corporate conduct, though there be an utter absence of directors' resolutions. Is it asked what they could have done to prevent the organization of the trust; how they were negligent and unfaithful as corporate officers by their omission to act; what good a mere protest or objection would have accomplished; what effective form their resistance could have assumed? The answer is that they could have refused to recognize the illegal transfer of the stock; they could have declined to register the new ownership upon their stock-books; they could have said, and acted upon their words, that the original stockholders remained not only the beneficial, but the legal owners of the stock; and, if the board of trustees appealed to the law, the resisting directors could challenge the legality of the transfer as moulded by the combination agreement, and might have defeated the trust and shattered it at the outset of its career. So much they could have done as corporate officers; so much it was their duty to have done as representatives of the corporation; and when, beyond that corporate neglect, they recognized the validity of the stock transfers in trust, put the new and unlawful ownership upon their books, and accepted its votes in the choice of new directors who were to throttle the independence of the corporation and chain it to the will of the trust, I think we must shut our eyes in wilful blindness if we fail to see both corporate neglect and corporate action.

It is true, as we are reminded, that the statute confers upon trustees and directors general authority to manage the stock, property and concerns of manufacturing corporations; and equally true that, as a general rule and as between the companies and those with whom they deal, the corporate action must be manifested through and by the directors; but other statutes indicate with equal plainness that there are corporate acts which the trustees cannot perform, and which affect and bind the corporation only upon the condition that they proceed from the stockholders, or from them and the trustees acting together. In increasing or diminishing the capital stock, the corporate act is wholly that of the corporators, and in consolidating two or more companies into one, there must be the joint action of both trustees and stockholders. The trust of the refineries, in substance and effect, approached very near to these two corporate acts, so far as the resultant conse-

quences affected the corporators acting. The trust stipulations practically doubled their corporate stock through the agency of the certificates issued, and the combination in its results is largely the equivalent of a substantial consolidation. If these things had been done lawfully, they would have been accomplished by the united action of trustees and corporators, and beyond any question would have been corporate acts. Having been done unlawfully, but by the same united aiming at similar results, they must still constitute corporate conduct, unless the bare fact of their illegality takes away their corporate character. To say that, would disarm the state in every case of misuse or abuse of chartered powers.

The abstract idea of a corporation, the legal entity, the impalpable and intangible creation of human thought is itself a fiction, and has been appropriately described as a figure of speech. It serves very well to designate in our minds the collective action and agency of many individuals as permitted by the law; and the substantial inquiry always is what in a given case has been that collective action and agency. As between the corporation and those with whom it deals, the manner of its exercise usually is material, but as between it and the state, the substantial inquiry is only what that collective action and agency has done, what it has, in fact, accomplished, what is seen to be its effective work, what has been its conduct. It ought not to be otherwise. The state gave the franchise, the charter, not to the impalpable, intangible and almost nebulous fiction of our thought, but to the corporators, the individuals, the acting and living men, to be used by them, to redound to their benefit, to strengthen their hands and add energy to their capital. If it is taken away, it is taken from them as individuals and corporators, and the legal fiction disappears. The benefit is theirs, the punishment is theirs, and both must attend and depend upon their conduct; and when they all act, collectively, as an aggregate body, without the least exception, and so acting, reach results and accomplish purposes clearly corporate in their character, and affecting the vitality, the independence, the utility, of the corporation itself, we cannot hesitate to conclude that there has been corporate conduct which the state may review, and not be defeated by the assumed innocence of a convenient fiction. As was said in *People ex rel. v. K. & M. T. R. Co.*, 23 Wend. 193, 35 Am. Dec. 551, "though the proceeding by information be against the corporate body, it is the acts or omissions of the individual corporators that are the subject of the judgment of the court."

It remains to determine whether the conduct of the defendant in participating in the creation of the trust, and becoming an element of it, was illegal and tended to the public injury, and we may consider the two questions together and without formal separation.

It is quite clear that the effect of the defendant's action was to divest itself of the essential and vital elements of its franchise by placing them in trust; to accept from the State the gift of corporate life only to disregard the conditions upon which it was given; to receive its powers



and privileges merely to put them in pawn; and to give away to an irresponsible board its entire independence and self-control. When it had passed into the hands of the trust, only a shell of a corporation was left standing, as a seeming obedience to the law, but with its internal structure destroyed or removed. Its stockholders, retaining their beneficial interest, have separated from it their voting power, and so parted with the control which the charter gave them and the State required them to exercise. It has a board of directors nominally and formally in office, but qualified by shares which they do not own, and owing their official life to the board which can end their power at any moment of disobedience. It can make no dividends whatever may be its net earnings, and must encumber its property at the command of its master, and for purposes wholly foreign to its own corporate interests and duties. At the command of that master it has ceased to refine sugar, and without any doubt for the purpose of so far lessening the market supply as to prevent what is termed "over production." In all these respects it has wasted and perverted the privileges conferred by the charter, abused its powers, and proved unfaithful to its duties. But graver still is the illegal action substituted for the conduct which the State had a right to expect and require. It has helped to create an anomalous trust which is in substance and effect, a partnership of twenty separate corporations. The State permits in many ways an aggregation of capital, but mindful of the possible dangers to the people, over-balancing the benefits, keeps upon it a restraining hand, and maintains over it a prudent supervision, where such aggregation depends upon its permission and grows out of its corporate grants. It is a violation of law for corporations to enter into a partnership. *N. Y. & S. C. Co. v. F. Bank*, 7 Wend. 412; *Clearwater v. Meredith*, 1 Wall. 29, 17 L. Ed. 604; *Whittenton Mills v. Upton*, 10 Gray (Mass.) 596, 71 Am. Dec. 681. The case last cited furnishes the reasons with precision and at length. It shows the utter inconsistency of a double allegiance by those who act for the corporation to two different principals, and demonstrates that the vital characteristics of the corporation are of necessity drowned in the paramount authority of the partnership. That the combination of the refineries partakes of the nature of a partnership is not denied. Indeed, in one of the papers added to the appellant's brief, it is not only admitted but asserted and defended. That paper shows quite clearly, that by force of the arrangement, there was a community of interest in the fund created by the corporate earnings before division, and that each member of the trust shared in the profit and loss of all. It is said, however, that a consolidation of manufacturing corporations is permitted by the law, and that the trust or combination or partnership, however it may be described, amounts only to a practical consolidation which public policy does not forbid because the statute permits it. (Laws of 1867, chap. 960; Laws of 1884, chap. 367.) The refineries did not avail themselves of that statute. They chose to disregard it, and to reach its

practical results without subjection to the prudential restraints with which the State accompanied its permission. If there had been a consolidation under the statute, one single corporation would have taken the place of the others dissolved. They would have disappeared utterly, and not, as under the trust, remained in apparent existence to threaten and menace other organizations and occupy the ground which otherwise would be left free. Under the statute the resultant combination would itself be a corporation deriving its existence from the State, owing duties and obligations to the State, and subject to the control and supervision of the State, and not, as here, an unincorporated board, a colossal and gigantic partnership, having no corporate functions and owing no corporate allegiance. Under the statute the consolidated company taking the place of the separate corporations could have as capital stock only an amount equal to the fair aggregate value of the rights and franchises of the companies absorbed; and not as here a capital stock double that value at the outset and capable of an elastic and irresponsible increase. The difference is very great and serves further to indicate the inherent illegality of the trust combination.

And here I think we gain a definite view of the injurious tendencies developed by its organization and operation, and of the public interests which are menaced by its action. As corporate grants are always assumed to have been made for the public benefit, any conduct which destroys their normal functions, and maims and cripples their separate activity, and takes away their free and independent action, must so far disappoint the purpose of their creation as to affect unfavorably the public interest; and that to a much greater extent when beyond their own several aggregations of capital they compact them all into one combination which stands outside of the ward of the State, which dominates the range of an entire industry, and puts upon the market a capital stock proudly defiant of actual values, and capable of an unlimited expansion. It is not a sufficient answer to say that similar results may be lawfully accomplished; that an individual having the necessary wealth might have bought all these refineries, manned them with his own chosen agents, and managed them as a group at his sovereign will; for it is one thing for the State to respect the rights of ownership and protect them out of regard to the business freedom of the citizen, and quite another thing to add to that possibility a further extension of those consequences by creating artificial persons to aid in producing such aggregations. The individuals are few who hold in possession such enormous wealth, and fewer still who peril it all in a manufacturing enterprise; but if corporations can combine, and mass their forces in a solid trust or partnership, with little added risk to the capital already embarked, without limit to the magnitude of the aggregation, a tempting and easy road is opened to enormous combinations, vastly exceeding in number and in strength and in their power over industry any possibilities of individual ownership; and the State by the

creation of the artificial persons constituting the elements of the combination, and failing to limit and restrain their powers, becomes itself the responsible creator, the voluntary cause of an aggregation of capital which it simply endures in the individual as the product of his free agency. What it may bear is one thing, what it should cause and create is quite another.

And so we have reached our conclusion, and it appears to us to have been established, that the defendant corporation has violated its charter and failed in the performance of its corporate duties, and that in respects so material and important as to justify a judgment of dissolution. Having reached that result, it becomes needless to advance into the wider discussion over monopolies and competition and restraint of trade and the problems of political economy. Our duty is to leave them until some proper emergency compels their consideration. Without either approval or disapproval of the views expressed upon that branch of the case by the courts below, we are enabled to decide that in this State there can be no partnerships of separate and independent corporations, whether directly, or indirectly through the medium of a trust; no substantial consolidations which avoid and disregard the statutory permissions and restraints, but that manufacturing corporations must be and remain several as they were created, or one under the statute.

The judgment appealed from should be affirmed with costs. All concur.

Judgment affirmed.

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### In re WATERTOWN PAPER CO.

(United States Circuit Court of Appeals, Second Circuit, 1909. 169 Fed. 252, 94 C. C. A. 528.)

Appeal from the District Court of the United States for the Northern District of New York.

The H. Remington & Son Pulp & Paper Company (designated in the opinion following as the "Pulp Company") appeals from an order disallowing a claim of \$72,775.45 presented by it against the bankrupt estate of the Watertown Paper Company (designated in the opinion as the "Paper Company").

Before LACOMBE, COXE, and NOYES, Circuit Judges.

NOYES, Circuit Judge.<sup>a</sup> The statement of the Pulp Company's claim as presented embraced items of "merchandise" furnished at various times from September 30, 1904, to November 16, 1905, amounting to \$72,775.45. The affidavit to which the statement was annexed stated that the consideration of the debt was "wood pulp sold and delivered." It appears from the books of the corporations, however, that said

<sup>a</sup> Portions of the opinion are omitted.



amount was really the balance of the running accounts between said corporations extending over a long period. It also appears that the accountant, in preparing the claim, took this balance from the books and sufficient of the late sales to amount thereto, and stated the one as the consideration of the other. \* \* \*

In considering the claim of the Pulp Company upon its merits, we must start with the assumption that, if the Paper Company were not a bankrupt, the claim would be valid and enforceable in the courts. The books of the corporations show that the balance in favor of the Pulp Company is the amount stated in the claim as presented. Indeed, the appellees say in their brief:

"No question is made in the proofs by contestants that the pulp mill did manufacture and deliver to the paper mill pulp to the extent and amount of vastly more than \$72,775.45. Nor is any question made but that said last mentioned sum represented the balance of the running account kept between the two mills and included all items from the organization of the Pulp Company in 1887 to the date of adjudication, whether of money, credits, or pulp."

The contention of appellees, however, is that the claim is unenforceable against the bankrupt estate of the Paper Company because—as they allege—the Pulp Company and the Paper Company are not two separate corporations, but one. "There is no such claim"—they say—"unless, indeed, the bankrupt can be said to have a claim against itself." In other words, they claim that the Pulp Company was merely an adjunct or branch of the Paper Company. It is necessary, therefore, before considering the legal questions, to examine the facts appearing in the record with respect to the organization, existence, and relations of the two corporations.

The bankrupt—the Paper Company—was organized in 1864 with a capital stock of \$14,000, which was afterwards increased to \$20,000. Prior to 1886 its entire capital stock was owned by Hiram Remington and Edward W. Remington. At that time Hiram Remington gave 20 shares to each of his three daughters, and the ownership remained the same down to the time of his death in 1905. The Pulp Company was organized in 1887 with a capital stock of \$20,000, of which \$10,000, was taken by Hiram Remington, \$9,500 by Edward Remington and \$500 by Nellie Remington, wife of Edward Remington. The stock of the Pulp Company was paid for by Hiram Remington and Edward Remington in the following manner: They both had credits of considerable sums upon the books of the Paper Company, which by their direction advanced the necessary funds to the Pulp Company and charged the advancements to their accounts. In 1902 the stock of this company was increased by a stock dividend to 128,000, all of which was held by the same stockholders. In March, 1905, Hiram Remington died, and his shares in the two corporations were distributed among his children. Prior to that time there had also been some changes in the holdings of Edward Remington and

his wife in the Pulp Company. It may be broadly stated, however, that during the entire existence of the Pulp Company prior to November, 1905, when John B. Taylor acquired the shares of the two corporations, the ownership of their stock had been in Hiram Remington and Edward Remington and their families. But it also appears that the several stockholders had different interests in the two corporations and that some owned stock only in one corporation.

The affairs of the two corporations were closely intermingled. For some years after the organization of the Pulp Company the Paper Company manufactured its own pulp; but in 1891 and thereafter it procured its supply from the Pulp Company and took substantially all that it produced. This it made into paper and sold it in the market. The corporations gave each other commercial paper and indorsed for each other. Separate books of accounts were kept for the two corporations; but the business was conducted from the office of the Paper Company. The Pulp Company had no bank account; all its bills being paid by the Paper Company and charged to its account. All credits of the Pulp Company were collected by the Paper Company and credited to it. A certain proportion of the office expenses was charged to the Pulp Company.

The case thus presented is one in which the stockholders of the two corporations are largely the same, in which both corporations have been under the same management, and in which their affairs have for years been involved and intermingled; and the legal question is whether these relations prevent the one corporation from enforcing against the bankrupt estate of the other a claim which, in case the latter corporation had remained solvent, would have been both valid and enforceable. It must be clearly borne in mind that this is not a case in which a creditor is suing a corporation upon the ground that it has so held itself out in connection with another corporation as, upon principles of estoppel, to render it responsible for a particular debt of the latter. Any legal principle which would prevent the Pulp Company from collecting its claim from the estate of the Paper Company would permit all the creditors of the Paper Company to look to the Pulp Company for the payment of their demands—would, in effect, extend the jurisdiction of the bankruptcy court over the Pulp Company's property.

Now, it is an elementary and fundamental principle of corporation law that a corporation is an entity separate and distinct from its stockholders and from other corporations with which it may be connected. The fact that the stockholders of two separately chartered corporations are identical, that one owns shares in another, and that they have mutual dealings, will not, as a general rule, merge them into one corporation, or prevent the enforcement against the insolvent estate of the one of an otherwise valid claim of the other. As said by the Supreme Court of Arkansas in *Lange v. Burke*, 69 Ark. 85, 88,



61 S. W. 165, in holding, in a case where two corporations were practically controlled by the same stockholders and had had intimate business relations, including the employment of the same bookkeeper, that a claim of one corporation would be enforced against the insolvent estate of the other:

"A corporation is an artificial being, separate and distinct from its agents, officers, and stockholders. Its dealings with another corporation, although it may be composed in part of persons who own the majority of the stock in each company, and may be managed by the same officers, if they be in good faith and free from fraud, stand upon the same basis, and affect it and the other corporation in the same manner and to the same extent, that they would if each had been composed of different stockholders and controlled by different officers."

And as said by the Circuit Court of Appeals for the Sixth Circuit in *Richmond, etc., Const. Co. v. Richmond, etc., R. Co.*, 68 Fed. 105, 108, 15 C. C. A. 289, 34 L. R. A. 625:

"The contract company was a legal corporation, wholly distinct and separate from the railroad company. The fact that the stockholders in each may have been the same persons does not operate to destroy the legal identity of either corporation. Neither does the fact that the one corporation exercised a controlling influence over the other, through the ownership of its stock or through the identity of stockholders, operate to make either the agent of the other, or to merge the two corporations into one."

See, also, *Waycross, etc., R. Co. v. Offerman R. Co.*, 109 Ga. 827, 35 S. E. 275; *Crane v. Fry*, 126 Fed. 278, 61 C. C. A. 260; *Watson v. Bonfils*, 116 Fed. 167, 53 C. C. A. 535; *Fitzgerald v. Missouri Pac. R. Co. (C. C.)* 45 Fed. 812; *Goodwin v. Bodcaw Lumber Co.*, 109 La. 1050, 34 South. 74; *Ex parte Fisher*, 20 S. C. 179; *White v. Pecos, etc., Co.*, 18 Tex. Civ. App. 634, 45 S. W. 207.

Unless, therefore, it can be shown that some exception to the general rule of separate corporate existence and liability applies in this case, it must follow that the claim of the Pulp Company should have been allowed. The only exceptions to that rule possibly applicable here are: (1) The legal fiction of distinct corporate existence will be disregarded, when necessary to circumvent fraud. (2) It may also be disregarded in a case where a corporation is so organized and controlled, and its affairs are so conducted, as to make it merely an instrumentality or adjunct of another corporation.

Under the first exception the cases are numerous which hold that a person cannot transfer his property to a corporation to defraud its creditors, nor employ a separate corporate existence to evade his liabilities. But there is nothing in the record showing any fraud in the organization of the Pulp Company or in its operation or management. It does not appear that the Pulp Company absorbed the assets of the Paper Company. In fact, the balance presented as its

claim by the Pulp Company is reached by deducting all the Paper Company's credits. It does not appear that the creditors of the Paper Company gave it credit in the belief that it owned the property of the Pulp Company. Indeed, the record is barren of any facts from which fraud can be found or inferred. So the question is whether the case presented comes within the second exception to the rule—whether the Pulp Company was merely an adjunct of the business of the Paper Company, an agency or instrumentality through which it acted.

There is, as the appellees point out, a line of cases holding that, when one corporation creates another corporation for a particular purpose and holds its stock, the latter will be treated as an agent of the former or as an instrumentality for carrying out its purposes. In these cases the controlling corporation has been held liable for the debts of the subordinate company. *Interstate Telegraph Co. v. Baltimore, etc., Telegraph Co.* (C. C.) 51 Fed. 49; *Baltimore & O. Tel. Co. v. Interstate Tel. Co.*, 54 Fed. 50, 4 C. C. A. 184, in which a railroad company organized a telegraph company with small capital—all of which it held—as a department of its business and was held liable for its debts, is an illustrative case along this line. But the principles of those cases are only indirectly applicable here. Neither the Paper Company nor the Pulp Company own any of the other's shares, and in no sense can it be said that the Paper Company organized the Pulp Company as a department of its business.

Probably the strength of the appellees' contention can best be tested by applying the principles of that which is probably the most favorable case for them which they cite—*Re Muncie Pulp Co.*, 139 Fed. 546, 71 C. C. A. 530, decided by this court. In that case a New York corporation, the stock of which was owned by two officers, engaged in a manufacturing business in Indiana and acquired certain gas and oil well properties there. It being desirable that a local corporation should be formed to acquire rights of way, such a corporation was organized, with the same stockholders as the first corporation, to which the latter transferred, without consideration, its gas and oil well properties. The local company kept no separate books, and its affairs were managed by the first corporation. The latter corporation went into bankruptcy, and it was held that the local company was merely the agent of the bankrupt corporation, and that its shares in the names of the officers, as well as its property, belonged in law to the bankrupt. In his opinion Judge Coxe said:

"The Great Western Company was undoubtedly a mere creature of the Pulp Company, having no independent business existence, and organized solely for the purpose of facilitating the business of the latter. The Great Western Company has no shadow of claim to the property in controversy, and to permit it or its president, or shareholders, to dispose of such property, is to sanction a fraud upon the creditors of the Pulp Company."

But the present case is not at all like the Muncie Case, nor like any of the other cases cited by the appellees. As already shown, no element of fraud is present. The Paper Company did not in any legal sense furnish the money to build the Pulp Company's plant. It is true that it actually advanced the funds; but it did so for the account of the Remingtons. It was merely the conduit through which the Remingtons' money passed to meet their obligations. It does not appear that the Paper Company ever had the slightest claim—legal or equitable—to any of the stock of the Pulp Company. It is true that the two corporations mingled their affairs. A creditor of one company might perhaps have a claim, based upon principles of estoppel, against the other. Lax business methods are clearly shown. Undoubtedly the controlling stockholders regarded the two corporations as being, in a general way, different departments of their business. But the separate corporate organizations were apparently kept up. Each corporation had its own creditors, its own assets, and conducted its business in its own name. Books of account were kept, showing their financial relations. The stockholders were not entirely the same. We cannot, upon these facts, hold that the corporations were identical, nor that the Pulp Company was merely an adjunct or instrumentality of the Paper Company. Instead of coming under the exceptions, this case seems clearly to come within the general rule that the distinct corporate existence of two separate although associated corporations will be regarded by the courts.

For these reasons, we think that the claim of the Pulp Company should have been allowed against the bankrupt estate of the Paper Company.<sup>7</sup> \* \* \*

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### III. Attributes and Incidents of a Corporation <sup>8</sup>

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#### ROBERTS v. ANDERSON.

(United States Circuit Court of Appeals, Second Circuit, 1915. 226 Fed. 7, 141 C. C. A. 121.)

This cause comes here on writ of error to review a judgment of the United States District Court for the Southern District of New York dismissing the complaint, which judgment was filed on March 8, 1915.

Before LACOMBE, COXE, and ROGERS, Circuit Judges.

ROGERS, Circuit Judge. This action arises under section 38 of the act of Congress approved August 5, 1909, known as the Corporation

<sup>7</sup> See article, "Piercing the Veil of Corporate Entity," by I. Maurice Wormser, 12 Columbia Law Review, 496.

<sup>8</sup> For discussion of principles, see Clark on Corp. (3d Ed.) §§ 6-8.



Tax Law, and acts amendatory thereof and supplemental thereto. The action is brought to recover corporation excise taxes paid by the defendant for the years 1909 and 1910. The issue presented to the court is whether the United States Express Company was or was not subject to the tax imposed. The amount of the tax paid for the year 1909 was \$5,613.12, and for the year 1910 was \$8,354.45. The plaintiff, therefore, asks for judgment for \$13,967.57 and interest from the date of the respective payments. These payments, it is averred, were not paid voluntarily, but under duress and protest.

Section 38 of the act (Comp. St. 1913, § 6300) provides as follows: "That every corporation, joint stock company or association, organized for profit and having a capital stock represented by shares, \* \* \* now or hereafter organized under the laws of the United States or of any state or territory of the United States, \* \* \* shall be subject to pay annually a special excise tax with respect to the carrying on or doing business by such corporation, joint stock company or association, \* \* \* equivalent to one per centum upon the entire net income over and above \$5,000 received by it from all sources during such year. \* \* \*"

No claim is made that the United States Express Company was organized under any law of the United States. That the company is organized for profit and has a capital stock represented by shares is not denied. The company avers that it is an unincorporated association or partnership, formed by agreement in New York City on April 22, 1854, and that ever since it has existed solely by virtue of that agreement and extensions thereof. It denies that it is organized or has ever existed under any law of the United States, or of the state of New York, or of any other state or territory. It avers that all its operations and activities have been carried on without a franchise or other rights than such as are allowed to individuals or to partnerships under the law of the land. Its agreement, it declares, has never depended upon any statute for its effectiveness. It denies that it has ever been contemplated that its association should derive a statutory privilege of doing business in a capacity other than that of a partnership or of individuals voluntarily associated for the purpose of carrying on the business provided for in the partnership agreement.

It appears that the company is conducting its business in 28 states, in the District of Columbia, and in the province of Ontario, and that it has some 4,500 offices. Under the original agreement of 1854 the company was to continue in existence for a term of 10 years unless sooner dissolved by law or by a vote of the directors. But in 1859 the term was extended for the further term of 20 years from May 1, 1864. In 1884 it was extended 20 years from May 1, 1884, and in 1903 it was extended 20 years from May 1, 1904. The articles of association state that the parties have agreed, and "do hereby severally and mutually covenant and agree, to form a joint-stock company, with the intent and purpose of doing and prosecuting a general express for-

warding agency, commission, banking, exchange and insurance business at and between the city of New York, and such other cities and towns in the United States, the Canadas, or other foreign countries, as the directors, hereinafter named, or their successors, may, from time to time, direct."

The property and management of the company is vested in a board of five directors. The board are given authority "to change, alter and fix" the number of persons that shall constitute the board, and in case of an increase thereof or otherwise to fill the vacancy thereby created. They also have the right by a unanimous vote to extend the term of the existence of the company. They are authorized at any time by a unanimous resolution to dissolve the company if deemed for its best interests. They are empowered to declare dividends out of net earnings, and are authorized in their discretion "to purchase, buy, sell or exchange any line or lines of express already established as well as to establish new lines and to run said lines and carry on the business thereof, so purchased or established under separate and distinct firm names or otherwise in the discretion of said board." They are authorized to assess the shares "for any losses, damages or expenses to which the company may be subjected in the prosecution of its legitimate business."

In the case of the refusal or neglect of any shareholder to pay and discharge any assessment whenever the same is called for by the board, the whole or so many of his shares as is necessary may be forfeited and sold. The shares have a face value of \$100, and the number of shares may be increased or decreased as the board of directors think best. There are at the present time 100,000 shares, owned by more than 1,500 members. The shares are assignable. It is provided that death or the incapacity of any member shall not operate as a dissolution of the company, but the survivors shall prosecute the business in the same manner as if no such death or incapacity had occurred. But in case of death the survivors have the right "to purchase and take the interest and shares of said deceased shareholder by paying to his legal representatives the actual value thereof at the time of his decease, to be determined by three disinterested persons to be mutually chosen by the parties interested, unless the heirs of such deceased shareholder shall be of age and legally competent to act and shall elect to retain and hold such share or shares in conformity with these articles." And it is provided that no shareholder in the company other than such person or persons as may be authorized by the board "shall have the right or authority to use or sign the associate name of the company, or the name of any firm belonging thereto, under any circumstances or pretext whatever."

The articles provide that: "All deeds of real estate and all bonds and mortgages or other sealed instruments, made to and for the benefit of said company, shall be made and executed to and by the president thereof and his successors, and all suits at law or in equity brought or



prosecuted for said company shall be in the name of the president thereof."

In *Eliot v. Freeman*, 220 U. S. 178, 31 Sup. Ct. 360, 55 L. Ed. 424 (1911) the Supreme Court held that the intention of Congress was to embrace within the corporation tax statute only such corporations and joint-stock associations as were organized under some statute, or derived from that source some quality or benefit at the common law.

It may be conceded that at common law and without statutory authority persons may associate themselves together in a joint-stock company with transferable shares. In *Lindley on Company Law* (6th Ed.) p. 193, it is said: "Upon the whole, therefore, it appears that there is no case deciding that a joint-stock company with transferable shares, and not incorporated by charter or act of Parliament, is illegal at common law; that opinions have nevertheless differed upon this question; that the tendency of the courts was formerly to declare such companies illegal; that this tendency exists no longer; and that an unincorporated company with transferable shares will not be held illegal at common law, unless it can be shown to be of a dangerous and mischievous character tending to the grievance of her majesty's subjects. The legality at common law of such companies may therefore be considered as finally established."

And that such is regarded as the law by the Supreme Court of the United States is seen in *Eliot v. Freeman*, *supra*, where joint-stock companies having transferable shares were recognized as not having derived any of their rights from the statutes. See, too, *Warner v. Beers*, 23 Wend. (N. Y.) 103, 147 (1840) where it is said that by the common law shares may be made transferable absolutely, and that the right to transfer shares may by agreement be incorporated into partnership articles.

It may be conceded that it is not necessary that an unincorporated association should have statutory authorization to have its real estate held by its president as a trustee for the members. Indeed, in *Eliot v. Freeman*, *supra*, the property of an unincorporated association was held by trustees, and it was admitted by the court that its right was not derived from any statute.

But it appears that the United States Express Company is in the enjoyment of certain rights or privileges which no unincorporated association enjoys at common law. In other words, that company derives from a statutory source a "quality or benefit not existing at common law." In the case of an unincorporated association the rule at common law is that it cannot sue or be sued in the name of the association or of its officers, but must sue in the name of all of the members composing it, however numerous they may be. See 22 Cyc. p. 477. The hardship and great inconvenience of making all the members of large unincorporated companies parties to actions have led to important remedial legislation in this country and in England. This legislation in substance provides that such associations may sue and be sued

in the name of a designated officer, as the president or treasurer of the company, who for the purposes of suit is substantially a corporation sole and the representative of the company, as distinct from the individuals composing it.

In 17 *American & English Encyc. of Law* (2d Ed.) p. 643, reference is made to the fact that modern legislation usually provides, in the case of unincorporated companies, that they may sue and be sued in the name of an officer who is the representative of the company, and it adds: "But such officer must be created or pointed out by law, since the partners or associates cannot by their own act empower one of their officers for the time being to represent the firm and sue and be sued on its behalf. Such a person would not be a representative, like a corporation sole, and could have no such standing as such in court."

We have no doubt that this is a correct statement of the law, and that the members of an unincorporated joint-stock company or association cannot, in the absence of a statute so providing, designate one of their officers to sue and be sued as the representative of the others. The question was so decided in *Hybart v. Parker*, 4 C. B. (N. S.) 209 (1858), where the three judges were unanimous. In his opinion Williams, J., said: "It may be, as Mr. Collier suggests, that the law operates hardly in the case of these companies; but, if it be a hardship, the remedy must be sought at the hands of the Legislature." Willes, J., said: "I agree with the rest of the court in thinking that this declaration cannot be supported, and for this additional reason: That, if we were to hold that the purser might maintain this action, it would be trenching upon the prerogative of the crown, by making a new species of corporation—a corporation sole for the purpose of bringing actions."

And the courts in New York recognize the same doctrine. In *Van Aernam v. Bleistein*, 102 N. Y. 355, 7 N. E. 537 (1896), Judge Rapallo points out that in the state of New York, prior to 1849, all the members of an unincorporated joint-stock company or association were necessary parties to an action by or against such company or association, whatever the number of its members might be. He says that: "Such an association could not sue in the name of any officer of the association or in the name of its trustees." He adds that Laws 1849, c. 258, § 1, provided that any joint-stock company or association, consisting of seven or more shareholders or associates, might sue or be sued in the name of the president or treasurer, for the time being, of such joint-stock company or association, and that suits so prosecuted should have the same effect on the joint rights or property of the company as if prosecuted in the names of all the shareholders or associates. And in an earlier case, *Westcott v. Fargo*, 61 N. Y. 542, 548, 19 Am. Rep. 300 (1875), the same doctrine was announced; the court saying: "Such an officer must be created by law, since the partners or associates cannot, by their own act, empower their treasurer or secretary, for the time being, to represent the firm and sue and be sued on

its behalf. Such a person would not be a representative, like a corporation sole, and could have no standing as such in court."

The statutes of the state of New York have endowed the United States Express Company with capacities and attributes not possessed by a partnership at common law. They have legalized attributes assumed by the United States Express Company and made valid and effective its asserted rights. The New York act of 1849, authorizing joint-stock companies to sue and be sued in the name of the president or treasurer, was followed by chapter 153 of the Laws of 1853, amending the former act so as to provide that suits against a joint-stock company should in the first instance be prosecuted against the president or treasurer of the company, and that suits could not be brought against individual shareholders until judgment against the company was returned unsatisfied. These provisions seem to be still in force, being incorporated in the Joint Stock Association Law (Consol. Laws, c. 29). Moreover the Constitution of New York, in article 8, § 3, provides as follows: "The term 'corporations' as used in this article shall be construed to include all associations and joint-stock companies having any of the powers or privileges of corporations not possessed by individuals or partnerships. And all corporations shall have the right to sue and shall be subject to be sued in all \* \* \* cases as natural persons."

It would seem that under the Constitution and laws of New York the United States Express Company is for all practical purposes a corporation. The fact that its members do not possess the important corporate attribute of limited liability is not material to the purposes of this suit. Corporations even exist under charter or statutory provisions where the members do not enjoy a restricted liability.

In *People ex rel. Platt v. Wemple*, 117 N. Y. 136, 22 N. E. 1046, 6 L. R. A. 303 (1889), the New York Court of Appeals had before it the validity of a tax imposed upon the United States Express Company under a statute of the state of New York (chapter 542 of the Laws of 1880) entitled "An act to provide for raising taxes for the use of the state upon certain corporations," as amended by subsequent acts (chapter 361, Laws of 1881; chapter 501, Laws of 1885). The statute declared that: "Every corporation, joint-stock company or association whatever, now or hereinafter incorporated or organized under any law of this state, or now or hereafter incorporated or organized by or under the laws of any other state or country and doing business in this state," should be subject to the tax. The court held that the United States Express Company was liable to the tax. The court said: "In view of the capacities and attributes with which, as we have seen, the United States Express Company is endowed, and in view, also, of the statutes which legalize its assumed capacities and make valid and effective its asserted right of succession, its distinctive name and the alienability of its shares, we find nothing to warrant the contention of the appellant that it is a mere partnership, existing only under its ar-



ticles of agreement and association. It is true those articles contain no reference to any statute of the state, as one under or by which the company was organized, yet, by the very constitution of the body itself and the privileges and powers which it can only exercise by virtue of those statutes, it must be taken to belong to one of those classes of artificial beings described in the act of 1880, *supra*, as 'a corporation, joint-stock company or association.'" And the court further said: "The word 'incorporated,' as here used, is not to be taken in a technical or restricted meaning and confined to an association brought into being according to the formula of a statute, but as including any combination of individuals upon terms which embody or adopt as rules or regulations of business the enabling provisions of the statutes. In the case before us the agreement, which brought many persons into one artificial body, was so framed as to accomplish that end, and in proposing to conduct its affairs by the power given to it in the mode prescribed by the Legislature, they must be deemed, for the purposes of the act in question, to be incorporated—that is, formed or united—under the law of the state, whether the artificial body be termed a corporation, a joint-stock company, or association." It also declared: "It is precisely such an association as, when formed without authority from Parliament, was declared in England to be illegal and void, and to be 'deemed a public nuisance' (6 Geo. I, c. 18, § 18); the statute in this respect following, it was said, the common law and enforcing its rules by the imposition of penalties."

In *Spraker v. Platt*, 158 App. Div. 377, 386, 143 N. Y. Supp. 440 (1913), the Appellate Division of the Supreme Court of New York, Third Department, it is declared that the United States Express Company is the creature of contract and exists by virtue of its articles of association and not by statute, and that joint-stock associations are not of statutory origin, but the creature of common law. We admit that this company did not organize under a statute, and that the common law permits the organization of joint-stock companies. We do not however understand that the court in that case meant to decide that the company derived no advantage from any statute of the state and possessed no rights under its articles, except such as the common law gave it. And it could not have so decided without overruling the Court of Appeals of the state.

The conclusion we have reached is that, while the United States Express Company is without a special charter and has not been organized under any statute, but is a joint-stock company created under articles of association or agreement, it nevertheless is in the enjoyment of valuable privileges which such a company did not possess at common law, but obtains by virtue of the statutes of New York. In *Cook on Corporations* (7th Ed.) vol. 2, § 505, that writer says: "There is an essential difference between a joint-stock company as it exists at common law and a joint-stock company having extensive statutory powers conferred upon it by the state within which it is organized.



The latter kind of joint-stock companies are found in England and in the state of New York. To such an extent have these statutory powers been conferred on joint-stock companies that the only substantial difference between them and corporations is that the members are not exempt from liability as partners for the debts of the company."

We think this language fitly describes the status of the United States Express Company, and that the company belongs to that class of joint-stock companies which it was the intention of Congress to tax under the Corporation Tax Act of 1909. Moreover the company has regarded itself as organized under the laws of New York. In *Chapman v. Barney*, 129 U. S. 677, 679, 9 Sup. Ct. 426, 428, 32 L. Ed. 800 (1889) it described itself as "a joint-stock company organized under and by virtue of a law of the state of New York, and which said company is authorized by the laws of the state of New York to maintain and bring suits, in the name of its president, for or on account of any right of action accruing to said company." See *Platt v. Colvin*, 50 Ohio St. 703, 36 N. E. 735. Judgment affirmed.

## CREATION AND CITIZENSHIP OF CORPORATIONS

I. Power of the State Legislatures<sup>1</sup>

## FALCONER v. CAMPBELL.

(United States Circuit Court, 1840. 2 McLean, 195, Fed. Cas. No. 4,620.)

Action against the directors of the Detroit bank to recover the amount of bill of exchange, drawn by the bank in favor of the plaintiffs on a New York bank, and protested for nonpayment. The declaration set forth the organization of the bank under the general banking law of 1838. The defendants filed a general demurrer.

McLEAN, J.<sup>2</sup> \* \* \* First: Are the associations authorized by the general law corporations?

Second: Had the legislature power to pass such a law?

The act in question is entitled "an act to organize and regulate banking associations." The first, second, third, fourth, fifth, sixth and seventh sections provide in what mode the associations shall be formed. Application is to be made, in writing, to the treasurer and clerk of the county, where the business is to be transacted, stating the amount of capital proposed. Of this application public notice is required to be given. Bond, in the sum of thirty thousand dollars, to be approved of by the treasurer and clerk, must be entered into. The capital stock is limited, and the subscriptions are to be received and apportioned, etc. Ten per cent. on shares subscribed are required to be paid.

And when the capital stock of the proposed association shall be subscribed and ten per cent. paid, on notice being given to the stockholders, they are authorized to meet and elect nine directors, a majority of whom are authorized to manage the affairs of the association. They are required to elect one of their number president; and in the ninth section it is provided, that "all such persons as shall become stockholders of any such association shall, on compliance with the provisions of the act, constitute a body corporate and politic in fact and in name, and by such name as they shall designate and assume to themselves, etc., and by such name they and their successors shall and may have continued succession, and shall, in their corporate capacity, be capable of suing and being sued, pleading and being impleaded, etc., in all courts whatsoever; and that they and their successors may have a common seal, and by such name as they shall designate, adopt and assume as aforesaid, shall be in law capable of purchasing, holding and conveying any estate, real or personal," etc. By the 15th section the directors, for the time being, or a majority of them, have power to make by-laws.

<sup>1</sup> For discussion of principles, see Clark on Corp. (3d Ed.) § 14.

<sup>2</sup> Portions of the opinion are omitted.

The ordinary powers of a corporation are—1. Perpetual succession. 2. To sue and be sued, and to receive and grant by their corporate name. 3. To purchase and hold lands and chattels. 4. To have a common seal; and 5. To make by-laws.

Some of these powers are incidents to a corporation, but they are all generally expressly given by a statute in this country, and these powers are all given in the act under consideration. It expressly provides that the association authorized by the act, when formed, shall "constitute a body corporate and politic in fact and in name."

The act not only gives in terms all the requisites to constitute a corporation, but the body, when formed, is technically designated by it as such. Where then is the ground for argument or doubt on the subject? Did not the legislature comprehend the force of the language they used? They have created an artificial being, giving to it in well defined terms its just proportions and powers, and have called it by its appropriate and technical name. Could the legislature in language more clear and forcible have created a corporation? Not a quasi corporation, not a joint stock company, or a limited partnership, but substantially and technically a corporation.

In illustration of this act of the legislature, it is unnecessary to refer to the mode of creating corporations in England by grant, or between an ancient and modern being of this sort. It exists between a body thus created and one created by a statutory grant, or between an ancient and modern being of this sort. It is enough to know that it is not essential to the character of a corporation, that its powers should be equal to any similar association, either ancient or modern. It is sufficient if in its corporate name it exercises the powers and rights of a natural person, in the management of its concerns.

We can entertain no doubt that the associations authorized under the above act were intended to be, and are, in fact, corporations.

Had the legislature power to pass this law? This is the great question in the case, and it is fully and fairly presented by the demurrer.

The second section of the twelfth article of the constitution of Michigan declares that "the legislature shall pass no act of incorporation, unless with the assent of at least two-thirds of each house." And it is earnestly, ingeniously and ably contended that this is an inhibition of the creation of corporations by a general law. That corporate powers, under it, can only be conferred by express enactment in each case. \* \* \*

We are told that the people of Michigan were jealous of monopolies, and especially of bank monopolies, and that by the introduction of the above section into their constitution they intended to restrict the powers of the legislature in making such grants. That such was their intention is clear from the language of the section. A law which confers corporate powers can only be passed by a vote of two-thirds of the members of each house. But must each corporation be created by a separate act? This is the ground taken in support of the demurrer.



No act of incorporation shall be passed by the legislature, unless with the assent of at least two-thirds of each house, are the words of the section. The word act is used in the singular, but does it necessarily import that not more than one corporation can be created in the same act?

Suppose ten distinct applications were made to the legislature for bank incorporations at the same session, and the legislature were disposed to grant each application, must they pass ten acts of incorporation, or may not the ten corporations be granted in the same act? Would not such a law be within the letter and spirit of the constitution? Of this there would seem to be little doubt.

As distinctive a character may be given to each corporation in such an act as if it were established by a special law. In 1834 an act was passed by the legislative council of the territory of Michigan, entitled "An act to establish branches of the Bank of Michigan, Farmers' and Mechanics' Bank of Michigan, and Bank of the River Raisin." Such acts are common, and it is believed never to have been supposed that the legislative power might not be exercised in this mode. The restriction in the constitution does not prohibit it.

And if this may be done under the constitution, then the construction, that each corporation must be created by a special law, can not be sustained. \* \* \*

At the time the constitution of Michigan was adopted, in many of the states and in this territory, it was the ordinary course of legislation to create corporations by a general law. This was the case in Ohio, and in many of the other states. And it can be of no importance whether banking or other associations were thus incorporated. The power was exercised. Does the constitution prohibit the exercise of this power?

It has already been shown that an act which shall establish several banking corporations is not repugnant to the constitution. And this reduces the objections to the law under consideration to two points:

First. That a corporation being a grant must be made to a person or persons in esse.

Second. The indefinite number of banking corporations which, under the law, may be established.

The first objection on examination will be found to have but little force.

The creation of a corporate existence can never take effect until the association be formed and the organization completed. Commissioners are generally designated in the act, who are to superintend the opening of the books and receive the subscriptions of stock. And when the amount shall be subscribed and the necessary payments made, the stockholders elect directors who appoint a president and cashier. The organization being completed, existence is given to the artificial being, and its agency commences. It is now in esse, but before this it was



not. Vitality is given to it by the voluntary association and organization of its members. Had they remained passive the law could have had no effect.

In this case then, the grant of the franchise is not made to a person or persons in esse. The commissioners did not constitute the corporation, nor was the franchise in any form or degree vested in them.

This is the general mode in which corporations are created, and it has stood the test of time, and of legal scrutiny. No valid objection is perceived to it.

In regard to this objection the act under consideration rests upon the same ground as other and more special acts on the same subject. The franchise is not vested in either until the organization be completed, and this depends upon the voluntary association of individuals.

In a special act commissioners are named to open the books and receive subscriptions of stock; in the act under consideration the clerk and treasurer of each county are required to perform this duty. They are commissioners for this purpose; and, so far as the grant is concerned, if it be valid under one law it must be so under the other.

We come now to consider the objection, that an indefinite number of banking corporations are authorized by the general law, and this, it is supposed, is not only repugnant to the policy, but the express provision of the constitution.

It can not be said that this law violates any express provision of the constitution. The extent of the provision referred to is that no act of incorporation shall be passed, except by at least a majority of two-thirds of each branch of the legislature.

Now, this does not limit the number of corporations which shall be established, nor the number which may be created in one act. The act must be passed by a majority of two-thirds, and this is the only express restriction on the subject. If the range of legislative power be restricted beyond this, it must be done by construction.

There may be a wide distinction between the policy of a general and a special banking law, but this is not the question for judicial cognizance. Is there such a difference in principle, as to make the one constitutional and the other unconstitutional? This is the inquiry now to be made.

As it regards the power of the legislature, it is unquestionable, whether they establish one or fifty banking institutions. The same power which may establish one bank, under the constitution, may establish fifty.

In the general law, as above observed, commissioners are appointed, the county clerk and treasurer, to receive subscriptions of the stock the same as in a special act. And the mode of organization, under both acts, is substantially the same.

The only difference seems to be that in the special act the number of corporations is limited, whilst under the general act they are indefinite.

And here it is contended that the legislature have, in substance, conferred the power to form corporations by voluntary associations, without exercising that special scrutiny, in each case, as is required by the constitution.

But is this a sound and practical view of the case?

It may be admitted that it derives great force from the disastrous results which have been realized under this law; but these have nothing to do with the question of power under consideration. Suppose the results had been as beneficial as they have been injurious, how changed would have been the argument. But the question remains unaffected by the good or evil which resulted from the law.

The legislature, in the exercise of their discretion, seem to have concluded that, by requiring securities on real estate, and subjecting the directors to certain liabilities, it would be good policy to multiply the banking institutions of the state. And in order to avoid the charge of monopoly, which had been so liberally applied to banking incorporations by a general law, they held out to the community at large equal privileges in forming such associations. The act which thus sanctions an indefinite number of banks, depending upon voluntary associations, is passed by the requisite majority of two-thirds of both houses of the legislature.

Now, what is the practical operation of this law? It, in effect, declares that the clerk and treasurer of each county in the state shall be authorized to open books and receive subscriptions of stock, and when the associations, thus formed, shall become organized, they shall be in fact and in name bodies corporate and politic. The law acts as directly upon associations thus formed as if it had been passed expressly to incorporate each association. It is special to each. And the difference between a general and a special law of this character, in this respect, seems to be that the one is passed on the special application of a few individuals, whilst the other is enacted under the influence of a general policy. But the question of power is the same.

May not the legislature determine the number of banks that shall be established? This will not be controverted. And if they may do this, may they not, under the constitution, pass an act, by a majority of two-thirds of each house, to establish voluntary associations without limiting their number?

Suppose the general law had limited the number of banks to be established under it to ten, could their power to pass the law have been doubted? They throw around the institutions, thus to be organized, all the guards and checks which they deem necessary for the public interest. The law acts as directly and distinctly upon each association as if it had been the only one established under it. And, in passing the law, the legislature exercise the same scrutiny as if they were about to incorporate only one bank. Such a law would be within the letter and spirit of the constitution. And if the legislature may do this, may they not fix on a greater number of banks than ten, or may

they not, in the exercise of their discretion, authorize the establishment of an indefinite number? Whether the number shall be large or small is a question of policy and not of constitutional power. If a large or indefinite number of corporations may be created in the same act, under as salutary restrictions as the creation of one, is the policy of the constitution disregarded?

It is contended that the general law throws off the restraints imposed by the constitution. But is this so? There is not a restriction in the exercise of corporate powers, which can be imposed by a special law, that may not be imposed under a general law. And the power of the legislature acts as directly in the one case as in the other. In the general law, then, there is no disregard of the restraints of the constitution. Having the power to establish more than one corporation in the same act, the legislature may establish many, or an indefinite number.

The number, whether indefinite or limited, does not render the law repugnant to the constitution. If it has been passed by the constitutional majority, it is within the restriction.

By the thirty-sixth section of this law the legislature reserve "the power to alter or amend the act, and to dissolve any association to be incorporated under its provisions, by a vote of two-thirds of each house."

Here is a power not usually reserved in granting franchises. And it would seem that, so far as the policy of the law may be considered, this reservation of power gives to the legislature as salutary a control over these grants, for the public good, as would have been exercised in acting on special applications for charters. And the presumption is, that if the general law had not passed, the number of banks, under special laws, would have been as great, and the consequences not less disastrous.

The evil is not to be found in the constitution, or in the construction of the constitution, but in the elements of which the government is composed. The true remedy is found in the sober reflection, experience and intelligence of the community. \* \* \*

Demurrers withdrawn.



## II. Power of Congress<sup>3</sup>

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### LUXTON v. NORTH RIVER BRIDGE CO.

(Supreme Court of the United States, 1894. 153 U. S. 525, 14 Sup. Ct. 891, 38 L. Ed. 808.)

This was a petition by the North River Bridge Company, incorporated by the act of congress of July 11, 1890, ch. 669, for the appointment under that act of commissioners to assess damages for the appropriation and condemnation, for the approaches to its bridge across the Hudson or North River, between the states of New York and New Jersey, of land of Sarah Luxton in the city of Hoboken and the county of Hudson, in the latter state. Upon the order of the circuit court, appointing commissioners, she sued out a writ of error, which was dismissed by this court, at the last term, because that order was not a final judgment. 147 U. S. 337, 13 Sup. Ct. 356, 37 L. Ed. 194. The commissioners afterwards made an award and report, assessing her damages at the sum of \$2,000, to the acceptance of which she objected, upon the grounds that the act of congress was unconstitutional, and particularly that congress could not confer the right of eminent domain upon the company. But the court overruled the objection, and adjudged that the award be approved and confirmed, and remain on record in the office of its clerk, and that, upon payment or tender of the sum awarded, the company might enter upon and take possession of the land for the purpose for which it was condemned. She thereupon sued out this writ of error.

MR. JUSTICE GRAY. The validity of the act of congress incorporating the North River Bridge Company rests upon principles of constitutional law, now established beyond dispute.

The congress of the United States being empowered by the constitution to regulate commerce among the several states, and to pass all laws necessary or proper for carrying into execution any of the powers specifically conferred, may make use of any appropriate means for this end. As said by Chief Justice Marshall, "the power of creating a corporation, though appertaining to sovereignty, is not, like the power of making war, or levying taxes, or of regulating commerce, a great substantive and independent power, which can not be implied as incidental to other powers, or used as a means of executing them. It is never the end for which other powers are exercised, but a means by which other objects are accomplished." Congress therefore may create corporations as appropriate means of executing the powers of government, as, for instance, a bank for the purpose of carrying on

<sup>3</sup> For discussion of principles, see Clark on Corp. (3d Ed.) § 15.



the fiscal operations of the United States, or a railroad corporation for the purpose of promoting commerce among the states. *McCulloch v. Maryland*, 4 Wheat. 316, 411, 422, 4 L. Ed. 579; *Osborn v. Bank of United States*, 9 Wheat. 738, 861, 873, 6 L. Ed. 204; *Pacific Railroad Removal Cases*, 115 U. S. 1, 18, 5 Sup. Ct. 1113, 29 L. Ed. 319; *California v. Pacific Railroad*, 127 U. S. 1, 39, 8 Sup. Ct. 1073, 32 L. Ed. 150. Congress has likewise the power exercised early in this century by successive acts in the case of the Cumberland or National Road from the Potomac across the Alleghenies to the Ohio, to authorize the construction of a public highway connecting several states. See *Indiana v. United States*, 148 U. S. 148, 13 Sup. Ct. 564, 37 L. Ed. 401. And whenever it becomes necessary for the accomplishment of any object within the authority of congress, to exercise the right of eminent domain and take private lands, making just compensation to the owners, congress may do this with or without a concurrent act of the state in which the lands lie. *Van Brocklin v. Tennessee*, 117 U. S. 151, 154, 6 Sup. Ct. 670, 29 L. Ed. 845, and cases cited; *Cherokee Nation v. Kansas Railway*, 135 U. S. 641, 656, 10 Sup. Ct. 965, 34 L. Ed. 295.

From these premises, the conclusion appears to be inevitable that, although congress may, if it sees fit, and as it has often done, recognize and approve bridges erected by authority of two states across navigable waters between them, it may, at its discretion, use its sovereign powers, directly or through a corporation created for that object, to construct bridges for the accommodation of interstate commerce by land, as it undoubtedly may to improve the navigation of rivers for the convenience of interstate commerce by water. 1 Hare's Constitutional Law, 248, 249. See acts of July 14, 1862, ch. 167, 12 Stat. 569; February 17, 1865, ch. 38, 13 Stat. 431; July 25, 1866, ch. 246, 14 Stat. 244; March 3, 1871, ch. 121, § 5, 16 Stat. 572, 573; June 16, 1886, ch. 417, 24 Stat. 78.

The judicial opinions cited in support of the opposite view are not, having regard to the facts of the cases in which they were uttered, of controlling weight.

Mr. Justice McLean, indeed, in an opinion delivered by him in the circuit court, by which a bill by the United States to restrain the construction of a bridge across the Mississippi river was dismissed, no injury to property of the United States and no substantial obstruction to navigation being shown, and there having been no legislation by congress upon the subject, took occasion to remark that "neither under the commercial power, nor under the power to establish post roads, can congress construct a bridge over a navigable water;" that "if congress can construct a bridge over a navigable water, under the power to regulate commerce or to establish post roads, on the same principle it may make turnpike or railroads throughout the entire country;" and that "the latter power has generally been considered as exhausted

in the designation of roads on which the mails are to be transported; and the former by the regulation of commerce upon the high seas and upon our rivers and lakes." *United States v. Railroad Bridge Co.*, 6 McLean, 517, 524, 525, Fed. Cas. No. 16,114.

The same learned justice repeated and enlarged upon that idea in his dissenting opinion in *Pennsylvania v. Wheeling Bridge*, 18 How. 421, 442, 443, 15 L. Ed. 435, where, after the *Wheeling Bridge*, constructed across the Ohio river under an act of the state of Virginia, had by a decree of this court, at the suit of the state of Pennsylvania, been declared to be in its then condition an unlawful obstruction of the navigation of the river, and in conflict with the acts of congress regulating such navigation, and therefore ordered to be elevated or abated, congress passed an act declaring the bridge to be a lawful structure in its then position and elevation, establishing it as a post road for the passage of the mails of the United States, authorizing the corporation to have and maintain the bridge at that side and elevation, and requiring the captains and crews of all vessels and boats navigating the river to regulate the use thereof, and of any pipes or chimneys belonging thereto, so as not to interfere with the elevation and construction of the bridge. Act of August 31, 1852, ch. 111, §§ 6, 7, 10 Stat. 112.

But the majority of this court in that case held that "the act of congress afforded full authority to the defendants to reconstruct the bridge." 18 How. 436, 15 L. Ed. 435. Mr. Justice Nelson, in delivering its opinion, said: "We do not enter upon the question whether or not congress possess the power under the authority of the constitution to establish post offices and post roads, to legalize this bridge, for conceding that no such powers can be derived from this clause, it must be admitted that it is, at least, necessarily included in the power conferred to regulate commerce among the several states. The regulation of commerce includes intercourse and navigation, and, of course, the power to determine what shall or shall not be deemed in judgment of law an obstruction to navigation; and that power, as we have seen, has been exercised consistently with the continuance of the bridge." 18 How. 431, 15 L. Ed. 435. And Mr. Justice Daniel, in a concurring opinion, sustaining the validity of the act of congress, said: "They have regulated this matter upon a scale by them conceived to be just and impartial, with reference to that commerce which pursues the course of the river, and to that which traverses its channel, and is broadly diffused through the country. They have at the same time, by what they have done, secured to the government and to the public at large the essential advantage of a safe and certain transit over the Ohio." 18 How. 458, 15 L. Ed. 435. A similar decision was made in the *Clinton Bridge*, 10 Wall. 454, 19 L. Ed. 969. See also *Miller v. New York*, 109 U. S. 385, 3 Sup. Ct. 228, 27 L. Ed. 971.

In the cases cited at the bar, of *The Passaic Bridges*, 3 Wall. 782, 16

L. Ed. 799, decided by Mr. Justice Grier in the circuit court, and of *Gilman v. Philadelphia*, 3 Wall. 713, 18 L. Ed. 96, and *Wright v. Nagle*, 101 U. S. 791, 25 L. Ed. 921, in this court, the bridge in question had been erected under authority of a state, and was wholly within the state, and no question arose or was considered as to the power of congress, in regulating interstate commerce, to authorize the erection of bridges between two states.

But in *Stockton v. Baltimore & New York Railroad*, 32 Fed. 9, Mr. Justice Bradley, sitting in the circuit court, upheld the constitutionality of the act of Congress of June 16, 1886, ch. 417, authorizing a corporation of New York and one of New Jersey to build and maintain a bridge, as therein directed, across the Staten Island Sound or Arthur Kill. 24 Stat. 78.

The reasons upon which the decision in that case rested were, in substance, the same as were stated by that eminent judge in two opinions afterwards delivered by him in behalf of this court, in which the power of congress, by its own legislation, to confer original authority to erect bridges over navigable waters, whenever congress considered it necessary to do so to meet the demands of interstate commerce by land, is so clearly demonstrated as to render further discussion on the subject superfluous.

In *Willamette Bridge v. Hatch*, 125 U. S. 1, 12, 13, 8 Sup. Ct. 811, 817 (31 L. Ed. 629) in which it was held that section 2 of the act of February 14, 1859, ch. 33 (11 Stat. 383), for the admission of Oregon into the Union, providing that "all the navigable waters of the said state shall be common highways, and forever free, as well to the inhabitants of said state as to all other citizens of the United States," did not prevent the state, in the absence of legislation by congress, from authorizing the erection of a bridge over such a river. Mr. Justice Bradley speaking for the whole court, said: "And although, until congress acts the states have the plenary power supposed, yet, when congress chooses to act, it is not concluded by anything that the states, or that individuals by its authority or acquiescence, have done, from assuming entire control of the matter, and abating any erections that may have been made, and preventing any others from being made, except in conformity with such regulations as it may impose. It is for this reason, namely, the ultimate (though yet unexercised) power of congress over the whole subject-matter, that the consent of congress is so frequently asked in the erection of bridges over navigable streams. It might itself give original authority for the erection of such bridges, when called for by the demands of interstate commerce by land; but in many, perhaps the majority, of cases its assent only is asked, and the primary authority is sought at the hands of the state."

In *California v. Pacific Railroad*, 127 U. S. 1, 39, 40, 8 Sup. Ct. 1073, 1080 (32 L. Ed. 150), it was directly adjudged that congress has authority, in the exercise of its powers, to regulate commerce among



the several states, to authorize corporations to construct railroads across the states as well as the territories of the United States; and Mr. Justice Bradley, again speaking for the court, and referring to the acts of congress establishing corporations to build railroads across the continent, said: "It can not at the present day be doubted that congress under the power to regulate commerce among the several states, as well as to provide for postal accommodations and military exigencies, had authority to pass these laws. The power to construct or to authorize individuals or corporations to construct national highways and bridges from state to state is essential to the complete control and regulation of interstate commerce. Without authority in congress to establish and maintain such highways and bridges, it would be without authority to regulate one of the most important adjuncts of commerce. This power in former times was exerted to a very limited extent, the Cumberland or National road being the most notable instance. Its exertion was but little called for, as commerce was then mostly conducted by water, and many of our statesmen entertained doubts as to the existence of the power to establish ways of communication by land. But since, in consequence of the expansion of the country, the multiplication of its products and the invention of railroads and locomotion by steam, land transportation has so vastly increased a sounder consideration of the subject has prevailed and led to the conclusion that congress has plenary power over the whole subject. Of course, the authority of congress over the territories of the United States, and its power to grant franchises exercisable therein, are, and ever have been, undoubted. But the wider power was very freely exercised, and much to the general satisfaction in the creation of the vast system of railroads connecting the East with the Pacific, traversing states as well as territories, and employing the agency of state as well as Federal corporations."

The act of congress now in question declares the construction of the North River Bridge between the states of New York and New Jersey to be "in order to facilitate interstate commerce," and it makes due provision for the condemnation of lands for the construction and maintenance of the bridge and its approaches, and for just compensation to the owners, which has been accordingly awarded to the plaintiff in error.

In the light of the foregoing principles and authorities, the objection made to the constitutionality of this act can not be sustained.

Judgment affirmed.



### III. Intention to Create a Corporation <sup>4</sup>

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#### DUNN v. UNIVERSITY OF OREGON.

(Supreme Court of Oregon, 1881. 9 Or. 357.)

This suit was brought by respondents in the circuit court for Lane county, to set aside a conveyance of real property situated in said county, from the Union University Association to the board of directors of the University of Oregon, executed on or about December 31, 1873, upon the ground of fraud, and to subject such property to the payment of certain judgments, which had been recovered in said court by respondents against said association.

The complaint alleges the due incorporation of the Union University Association as a private corporation under the laws of Oregon, and the creation of the board of directors of the University of Oregon by act of the legislature, approved October 19, 1872, subsequently changed to the "Regents of the University," by act of the legislature October 21, 1876. It also shows that in the year 1873, and prior to the conveyance sought to be impeached, the Union University Association became indebted to the respondents severally in large amounts which have never been paid. That at the time said indebtedness accrued, and prior thereto, said association was the owner in fee-simple of certain real property in Eugene City, in said county, worth \$50,000, and gives a description of it by metes and bounds. That said real estate was all the property owned by said association, and that by conveying it to the board of directors of the University of Oregon, it made itself insolvent, and thereupon became and has ever since remained wholly unable to pay its debts. That said conveyance was executed in fraud of the rights of the respondents, and for the purpose of hindering and delaying them in collecting their said debts, and that there was no consideration therefor, and these facts were fully within the knowledge of said board of directors when they received said conveyance.

Prior to instituting this suit the respondents severally duly recovered judgments against the Union University Association upon their said claims, in said circuit court, and caused them to be duly docketed in said county, and executions to be issued and placed in the hands of the sheriff for service, which were duly returned by him wholly unsatisfied. \* \* \*

The board of regents demurred, and the court below overruled the demurrer, and upon their failing to answer, rendered a decree for respondents as prayed for in their complaint. From this decree the board of regents have brought this appeal. \* \* \*

<sup>4</sup> For discussion of principles, see Clark on Corp. (3d Ed.) § 21.

WATSON, J.<sup>5</sup> That the state university itself was incorporated under the provisions of the act of October 19, 1872, entitled "an act to create, organize and locate the university of the state of Oregon," is not claimed; but that the "board of directors" created by that act was an incorporated body can hardly be denied. Section 2 declares: "The general government and superintendence of the university shall vest in a board of directors, to be denominated the board of directors of the university of Oregon," to consist of nine members, all of whom shall be citizens and permanent residents of the state of Oregon."

Section 4 provides: "The board of directors shall have the custody of the books, records, buildings and all other property of the university. All lands, money, bonds, securities and other property which shall be donated, transferred or conveyed to the said board of directors by gift, devise or otherwise, for the use and benefit of the university, shall be taken, received, held and managed, invested and reinvested, sold, transferred and in all respects managed, and the proceeds thereof used, bestowed and invested in the manner, for the purpose and under the terms and conditions respectively prescribed by the act or gift, devise or other act in the respective cases. They shall have power, and it shall be their duty, to enact by-laws for the government of the university; to elect a president of the university, and the requisite number of professors, instructors, and employes, and to fix their salaries and the term of office of each, and to do all other acts necessary and proper to carry out the design of this act."

Sections 11 and 12 provide, that on or before January 1, 1874, "The Union University Association of Eugene City, Ore., shall secure a site for said university at or in the vicinity of Eugene City, and erect thereon and furnish a building for the use of the state university, on a plan to be approved, and, after the erection of the same, to be accepted by the board of commissioners for the sale and management of the school and university lands, and for the investment of the funds arising therefrom; said building and furniture to be of not less value than \$50,000; and to convey the said site and building, in fee-simple, free from all incumbrances, to said board of directors, on or before said January 1, 1874."

By an amendatory act, passed October 16, 1874, the time was extended to January 1, 1877, for securing such site and building and conveying them to the board of directors.

While it cannot be denied that some of these powers might be exercised by a board of directors in their collective capacity, without being incorporated, it is equally undeniable that some of them could not. The capacity and power to take conveyances of lands and hold and dispose of them for the use and benefit of the university, according to the various and diverse trusts imposed upon them by their donors, and to transmit title to lands to their successors in office in perpetual succes-

<sup>5</sup> The statement of facts is abridged and a portion of the opinion is omitted.

sion, without intermediate conveyances, could not belong to this board of directors unless incorporated.

It is true the legislature has not declared it to be a corporation in express terms, but this was not essential. (Angell & Ames on Corporations, § 76; *Thomas v. Dakin*, 22 Wend. [N. Y.] 70, 103, 106.)

"It is indeed a principle of law which has been often acted on, that where rights, privileges and powers are granted by law to an association of persons by a collective name, and there is no mode by which such rights can be enjoyed, or such powers exercised, without acting in a corporate capacity, such associations are, by implication, a corporation, so far as to enable them to exercise the rights and powers granted." (Angell & Ames on Corporations, § 78.) \* \* \*

The decree of the court below is affirmed with costs.

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#### IV. Agreement between Corporation and State—Acceptance of Charter \*

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##### STATE v. DAWSON.

(Supreme Court of Indiana, 1864. 22 Ind. 272.)

WORDEN, J. This was an information against the appellees, charging them in substance, with usurping and exercising the powers and functions of a railroad corporation, under the pretended authority of an act of the legislature, entitled, "An act to Incorporate the Fort Wayne and Southern Railroad Company," approved January 15, 1849. It is alleged that the corporators named in the act did not accept the charter and franchises until June, 1852; that as there had been no acceptance of the charter up to November 1, 1851, the act was then repealed by the Constitution of the State, which then took effect. Prayer for judgment of ouster.

Issue, trial, finding, and judgment for the defendants.

The case comes before us on the evidence.

In the case of *State v. Dawson*, 16 Ind. 40, it was held that if the charter was not accepted by the corporators until the new constitution took effect, it was thereby repealed, and no valid organization could thereafter take place under the act. The question was there decided on demurrer. In the case before us, an issue of fact was made and tried; and the evidence shows, as we think, pretty conclusively, that the corporators named in the act did accept the charter before the new constitution took effect.

The act in question provides that Allen Hamilton and others, naming them, and their associates and successors in office, etc., "are hereby

\* For discussion of principles, see *Clark on Corp.* (3d Ed.) §§ 23, 24.



constituted a body corporate and politic, by the name and style of the Fort Wayne and Southern Railroad Company, and shall be able and capable in law to sue and be sued," etc.

It was not only proven that the corporators applied to the legislature for the passage of the act in question, already drawn up as passed, excepting the clause authorizing a repeal; that one of the corporators appeared before a legislative committee, to whom the bill was referred, and on behalf of himself and the other corporators, explained to the committee the objects of the proposed organization; but it was also proven that, after the legislature appended the clause authorizing a repeal in certain cases, such of the corporators as were present, one of whom, at least, appears to have been acting by the authority, express or implied, of those who were absent, met together and consulted upon the amendment, and agreed to accept the charter in that form. If the evidence stopped here, it would be clearly sufficient to show an acceptance. "If a peculiar charter is applied for, and it is given, there can be no reasonable ground to doubt of its immediate acceptance." Ang. & Ames on Corp. § 83.

But in addition to this, the evidence shows that in October, 1851, a meeting was held of a majority of the corporators named, when they determined to build the contemplated railroad, under the charter.

The corporators having accepted the charter before the constitution of 1851 took effect, it became a valid, binding contract between the State and the corporators, which could not be abrogated or impaired except for cause.

The judgment below is affirmed.



## EFFECT OF IRREGULAR INCORPORATION

### I. Corporations De Facto<sup>1</sup>

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#### EMERY v. DE PEYSTER.

(Supreme Court of New York, Appellate Division, 1902. 77 App. Div. 65, 78 N. Y. Supp. 1056.)

Appeal by the plaintiff, Samuel Emery, from a judgment of the Supreme Court in favor of the defendant, entered in the office of the clerk of the county of New York on the 1st day of March, 1902, upon the dismissal of the complaint after a trial before the court and a jury at the New York Trial Term.

PATTERSON, J. The plaintiff sued to enforce against the defendant the statutory liability of a director of a corporation for the non-filing of an annual report in January, 1900. The allegation of the complaint is that the defendant, from May to November of the year 1900, was a director and president of the corporation, and that the plaintiff in July, 1900, was employed by that corporation to render certain services to it, and that he was wrongfully discharged and suffered damages by reason of such discharge. The defendant admits that he was a director and president of the corporation from May to November, 1900, and that no report was filed of the affairs of the company in 1900. The plaintiff did not charge specifically that the corporation was in existence on the 1st of January, 1900, and upon the trial he was allowed to amend his complaint by alleging incorporation prior to January 1, 1900, and the defendant was allowed to amend his answer by denying such incorporation prior to January 1, 1900.

It appeared in evidence that a certificate of incorporation was filed with the Secretary of State of the State of New York on the 21st of December, 1899, but no certificate was filed in the office of the county clerk of the county of New York, which was the place at which the corporate business was to be carried on. The incorporation, therefore, was incomplete. Thereupon the plaintiff undertook to prove that a de facto corporation existed prior to January, 1900. He showed an attempt to incorporate under a general law by filing a certificate with the Secretary of State and then made the effort to prove acts of user, such as would establish the existence of a de facto corporation. The only evidence offered on that subject is contained in the minutes of a meeting of the board of directors of the corporation held December 22, 1899, the day after the certificate of incorporation was filed in

<sup>1</sup> For discussion of principles, see Clark on Corp. (3d Ed.) §§ 41, 42.

the office of the Secretary of State. In those minutes it is stated that the incorporation papers as presented by the attorney for the company were accepted and filed in its office. Upon motion, duly seconded, the election of officers was proceeded with and a president, vice-president, secretary and treasurer were elected. Then the following resolution was passed: "Whereas it is necessary for the welfare of the company to acquire certain rights now owned by Raymond L. Donnell in order to enter into business, it is hereby, Resolved that the proper officers be and are hereby authorized and instructed to issue to said Raymond L. Donnell one thousand dollars in cash and nineteen hundred shares of the capital stock of this company in full payment for his entire interest in the publication known as the 'Railway News.' There being no further business, the meeting adjourned."

The purpose for which the corporation was to be formed was "to do a general publishing and printing business." There is no evidence of any business act done by the corporation prior to January 1, 1900, in furtherance of that purpose. All that was done at the meeting of the board of directors was preliminary to beginning business. An organization of the corporation was effected and the purpose to do business was indicated, but there is no proof to show that the thousand dollars was ever paid to Donnell or the shares of stock issued to him, or that any executed contract was made with him or any one else. Nor is there one word of proof of any business transaction being had by the corporation during the year 1899. There was merely preparation for business and nothing more. That it did not begin to do business until March, 1900, is affirmatively shown in the testimony of Brooks, the vice president.

To make proof of the existence of a de facto corporation, it is necessary to show not only that there is a law under which the corporation might be organized and an attempt to organize it, but that corporate powers have been exercised. That is, that the corporation has exercised its particular franchise by doing business under it. In *Methodist Episcopal Union Church v. Pickett*, 19 N. Y. 482, it is said that where there is a valid law under which a corporation may exist and the record shows a bona fide attempt to organize under it, very slight evidence of user beyond that is necessary, but none of the cases to which our attention has been called holds that the mere organization of the corporation by the election of officers and the passage of resolutions by directors relating to contracts purely executory in their nature, constitute acts of user of the franchise. That was held even of acts of a de jure corporation. In *Kirkland v. Kille*, 99 N. Y. 390, 2 N. E. 36, the action was brought against defendants, trustees of the Globe Smelting Company, to recover a debt of the company on the ground that the defendants had failed to make and file an annual report for the year 1876, as required by the General Manufacturing Act (Laws of 1848, chap. 40, § 12, as amended by Laws of

1875, chap. 510). There, the company was fully organized for the purpose "of carrying on a mining, smelting and metallurgical business, to accumulate, conduct and supply water for mining purposes." The whole capital stock was issued in payment of mining property, smelting works and real estate; officers were elected and their salaries fixed and the directors resolved to issue bonds to be secured by mortgage on the entire property of the company. At another meeting of the directors, it was resolved that immediate action was required to protect the property of the company and pay expenses already contracted on that account. In commenting upon these facts, the court said: "Not only was there no evidence that any other than formal acts were performed by the company in furtherance of the objects of its organization, but it was proven without contradiction 'that it never got into business;' 'that it never conducted or carried on a mining, smelting or metallurgical business, or that of accumulating, storing or conducting a supply of water for mining purposes.' In short, 'that it never performed any part of the business for which it was incorporated.' The bonds were not negotiated, and even the preliminary work of examination of the property by the consulting engineer, and 'assessment work,' that is, work done on the claim to protect the title, ceased in the early part of 1875. 'It never dug out any ore with a view to smelting.' The last of any kind was in June, 1875. There was at no time a superintendent. Under these circumstances we think no report in 1876 was required from the company. It never had the material capacity to do business. Even its effort to acquire it ceased and its intention to do so was given up in 1875."

We are of the opinion in this case that there was no user prior to the 1st of January, 1900; that a de facto corporation did not exist prior to that date, and, hence, the provisions of the statute requiring the filing of an annual report, which provisions are highly penal in their nature, are not applicable in this case and that the complaint was properly dismissed.

The judgment appealed from should be affirmed, with costs.

VAN BRUNT, P. J., and INGRAHAM, HATCH, and LAUGHLIN, JJ., concurred.

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### CLARK v. AMERICAN CANNEL COAL CO.

(Supreme Court of Indiana, 1905. 165 Ind. 213, 73 N. E. 1083, 112 Am. St. Rep. 217.)

Suit by the American Cannel Coal Co. against Emma L. Clark. From a decree for plaintiff, defendant appeals. Reversed.

MONKS, J.<sup>2</sup> This suit was brought by appellee to enjoin appellant from mining and removing fire-clay from certain real estate in Perry county, and to quiet appellee's title to said fire-clay. Appellee sold

<sup>2</sup> Portions of the opinion are omitted.



and conveyed said real estate by deed to a remote grantor of appellant on September 20, 1866, and claims to own said fire-clay by virtue of the reservation contained in said deed. A trial of said cause resulted in a final decree quieting appellee's title to said fire-clay and enjoining appellant from removing the same.

The first question to be determined is: was appellee, when it commenced this suit, an existing corporation having the power to sue? If this question be answered in the negative this case must be reversed. It appears from the record that appellee—a corporation—was created by special act (Local Laws 1838, p. 216), to continue for a period of fifty years from December 23, 1837. The powers granted were to mine for coal, "purchase, receive, hold and enjoy lands, coal, iron and other mines, \* \* \* and the same to sell, convey and demise." In 1885 the legislature passed an act (Acts 1885, p. 121, §§ 5124-5128, Burns 1901), which purported to extend the corporate existence of every private corporation, created or organized by special act for the purposes of mining stone, coal, iron ore, etc., thirty years after the passage of said act, whose board of directors, within sixty days after the passage of said act of 1885, shall avail itself of the provisions of said act by adopting resolutions to that effect, and filing the same with a statement giving the title and date of the act creating said corporation and of each act amendatory or supplemental to said creative act. The board of directors of appellee complied with the requirements of said act of 1885 on May 30, 1885, and appellee claims that thereby its corporate existence was extended thirty years from that time. Since 1837 until the commencement of this action appellee has exercised corporate powers under said special act of 1837 and the act of 1885. Appellant's position is that, as the special act of December 23, 1837, creating appellee a corporation, fixed the life of said corporation at fifty years, it ceased to exist when that period was ended, in 1887; that said act of 1885 was unconstitutional, and the attempt to continue the corporate existence of appellee by complying with its provisions was without effect; that appellee having ceased to exist as a corporation, cannot maintain this action. The act of April 2, 1885, *supra*, which appellee claims continued its corporate existence for thirty years from the date of its passage, is clearly unconstitutional under the rule declared in *Re Bank of Commerce* (1889) 153 Ind. 460, 53 N. E. 950, 55 N. E. 224, 47 L. R. A. 489.

Appellee insists, however, that appellant cannot raise any question in regard to the constitutionality of said act of 1885 in this case, because (1) it is at least a *de facto* corporation, and therefore impervious to collateral attack; (2) that appellant is estopped from denying its corporate existence. It is true, as claimed by appellee, that the corporate existence of a *de facto* corporation can only be questioned in a direct proceeding brought for that purpose. *Doty v. Patterson*



(1900), 155 Ind. 60, 64, 56 N. E. 668, and authorities cited. It is essential to the existence of a de facto corporation, however, that there be (1) a valid law under which a corporation with the powers assumed might be incorporated; (2) a bona fide attempt to organize a corporation under such law; (3) and an actual exercise of corporate powers. *Doty v. Patterson*, supra; 10 Cyc. Law & Proc. 252-256; 1 Clark & Marshall, Priv. Corp. §§ 82a, 82b. It follows, therefore, that there cannot be a corporation de facto when there cannot be one de jure. If there is no law under which a corporation de jure might exist, its nonexistence may be set up even in a collateral proceeding. \* \* \*

"To be a corporation de facto it must be possible to be a corporation de jure, and acts done in the former case must be legally authorized to be done in the latter, or they are not protected or sanctioned by the law. Such acts must have an apparent right." *Evenson v. Ellingson* (1887) 67 Wis. 634, 646, 31 N. W. 342, 347. It necessarily follows that there cannot be a corporation de facto under an unconstitutional statute, for such a statute is void, and a void law is no law. 1 Clark & Marshall, Priv. Corp. p. 246; Black, Const. Law, p. 64; *Snyder v. Studebaker*, supra, 19 Ind. 462, 81 Am. Dec. 415; *Harri-man v. Southam*, supra, 16 Ind. 190; *Heaston v. Cincinnati, etc., R. Co.*, supra, 16 Ind. 275, 79 Am. Dec. 430; *Eaton v. Walker*, supra, 76 Mich. 579, 43 N. W. 638, 6 L. R. A. 102; *Norton v. Shelby County* (1886) 118 U. S. 425, 6 Sup. Ct. 1121, 3 L. Ed. 178.

If the law under which a corporation is organized, or the special act creating the corporation, fixes a definite time when its corporate life must end, it is evident that when that date is reached, said corporation is ipso facto dissolved without any direct action on the part of the state or its members. And no corporate powers can thereafter be exercised by it except such as are given it by statute for the purpose of winding up its affairs, which in this State is limited to three years after the dissolution. \* \* \*

Appellee in 1866 at the time its deed for the land in controversy was executed to appellant's remote grantor, was a corporation de jure by virtue of the special law of December 23, 1837 (Local Laws 1838, p. 216). Even if appellant who claims the real estate in controversy and the right to mine said fire-clay and remove the same under appellee's deed of September 20, 1866, is estopped to deny its corporate existence, such estoppel only operates to prevent a denial of its corporate existence at the time the deed was executed in 1866, and in no way prevents appellant from alleging facts showing that the period fixed for its existence as a corporation expired in 1887, and that there was no such corporation in existence when this action was commenced. This is true because after a corporation is dissolved by a judicial decree or by the expiration of the period fixed for its existence in the law under which it is organized, it is not even a de facto corporation, and its existence as a corporation may be questioned collaterally. \* \* \*

As the corporate existence of appellee fixed by the special act of 1837 ended in 1887, and the three years given by § 3429, Burns 1901, § 3006, R. S. 1881 and Horner 1901, for the purpose of winding up its affairs ended in 1890, and the act of 1885 (Acts 1885, p. 121), under which appellee claims its corporate existence was extended thirty years, is unconstitutional, it follows that appellee had no power to sue when this action was commenced.

Judgment reversed.

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## II. Estoppel to Deny Corporate Existence \*

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### SNIDER'S SONS CO. v. TROY.

(Supreme Court of Alabama, 1890. 91 Ala. 224, 8 South. 658, 11 L. R. A. 515, 24 Am. St. Rep. 887.)

CLOPTON, J.<sup>4</sup> A corporation de facto exists when, from irregularity or defect in the organization or constitution, or from some omission to comply with the conditions precedent, a corporation de jure is not created, but there has been a colorable compliance with the requirements of some law under which an association might be lawfully incorporated for the purposes and with the powers assumed, and a user of the rights claimed to be conferred by the law, when there is an organization with color of law, and the exercise of corporate franchises and functions. *M. E. Church v. Pickett*, 19 N. Y. 482; *Stout v. Zulick*, 48 N. J. Law, 599, 7 Atl. 362.

The enabling law under which a corporation for the purposes and objects of the Dispatch Publishing Company, and with the powers assumed, might have been lawfully created at that time, is contained in sections 1803-1812 of the Code of 1876, and the amendatory acts, which authorize and provide for the incorporation of two or more persons desirous of forming a private corporation for the purpose of carrying on any industrial or other lawful business not otherwise specially provided for by law. Acts 1882-83, p. 40. The plea avers that defendant and two other named persons filed, September 2, 1885, with the judge of probate of Montgomery county, a written declaration, signed by themselves, setting forth substantially the matters required by the statute, except the residences of the persons, that they organized by the election of three directors, and commenced and continued to do business in a corporate capacity, and were so doing business when the debt sued for was contracted. If the averments of the plea be true, the truth of which is admitted by the demurrer, the Dispatch Publishing Company was an association having capital stock

\* For discussion of principles, see Clark on Corp. (3d Ed.) §§ 43, 44.

<sup>4</sup> The statement of facts is omitted.

divided into shares, organized by the election of officers, and transacting business, and exercising franchises, functions, and powers, after an attempted incorporation, as if it were a corporation de jure, a colorable compliance with the requirements of an existing and enabling law, and user of the rights claimed to be conferred thereby, the essential elements of a corporation de facto. *Central A. & M. Ass'n v. Alabama G. L. Ins. Co.*, 70 Ala. 120.

Appellant seeks by the action to hold defendant, who was a member, liable as a partner for paper and other supplies sold to the Dispatch Publishing Company. Whether the shareholders in a corporation de facto are individually liable for the corporate debts, in the absence of fraud or a statute, is a question as to which the authorities are in direct antagonism. In *Cook, Stocks*, § 233, the doctrine asserted is: "A corporate creditor, seeking to enforce the payment of his debt, may ignore the existence of the corporation, and may proceed against the supposed stockholders as partners, by proving that the prescribed method of becoming incorporated was not complied with by the company in question." The leading cases supporting this doctrine are *Bigelow v. Gregory*, 73 Ill. 197; *Abbott v. Smelting Co.*, 4 Neb. 416; *Garnett v. Richardson*, 35 Ark. 144; *Ferris v. Thaw*, 72 Mo. 446; *Ridenour v. Mayo*, 40 Ohio St. 9; *Coleman v. Coleman*, 78 Ind. 344. We have omitted reference to a few cases, sometimes cited, for the reason, that either the question of liability as partners was not before the court, as in *Blanchard v. Kaull*, 44 Cal. 440; or the debt was contracted before any steps were taken, other than the mere filing of a certificate, towards organization, as in *Bergen v. Fishing Co.*, 41 N. J. Eq. 238, 3 Atl. 404; or it was contracted after the expiration of the charter by its own limitation without reorganization, as in *Bank v. Landon*, 45 N. Y. 410. In the case last cited, the shareholders entered into a special agreement, which by its terms created a partnership as to third persons. In 2 Mor. Priv. Corp. § 748, the doctrine is stated as follows: "If an association assumes to enter into a contract in a corporate capacity, and the party dealing with the association contracts with it as if it were a corporation, the individual members cannot be charged as parties to the contract, either severally or jointly or as partners." The following cases maintain the doctrine that the members of a corporation de facto cannot be held liable as partners for the corporate debts. *Fay v. Noble*, 7 Cush. 188; *Bank v. Almy*, 117 Mass. 476; *Stout v. Zulick*, 48 N. J. Law, 599, 7 Atl. 362; *Bank v. Padgett*, 69 Ga. 164; *Bank v. Stone*, 38 Mich. 779; *Humphreys v. Mooney*, 5 Colo. 282; *Bank v. Walker*, 66 N. Y. 424; *Coal Co. v. Maxwell* (C. C.) 22 Fed. 197; *Whitney v. Wyman*, 101 U. S. 392, 25 L. Ed. 1050.

The plea and demurrer do not raise the question of the liability of the supposed stockholders, as partners, where there has been no intention or attempt to incorporate, where they are acting as a body corporate without even color of legislative authority, by sheer usurpation. The plea avers that the debt sued for was contracted by the Dispatch



Publishing Company, which is alleged to have been a *de facto* corporation, and that plaintiff sold the goods to, and contracted with, the company as a corporation, knowing that it was doing business as such. The question before us, and the only question we propose to decide, is whether, there being no fraud alleged, nor statute making the stockholders individually liable, a creditor, who has dealt with a *de facto* corporation as a corporation, who has entered into contractual relations with it in its corporate name and capacity, can disregard the existence of the corporation, and, electing to treat it as a partnership, enforce the collection of his debt from the stockholders individually? The conflicting authorities afford aid in the solution of this question, only so far as their opinions may be in accord with settled principles and sustained by reason. Though it is an undecided question in this state, principles have been well settled which materially bear upon the inquiry, and mark the way to a correct conclusion.

Corporations may exist either *de jure* or *de facto*. If of the latter class, they are under the protection of the same law, and governed by the same legal principles, as those of the former, so long as the state acquiesces in their existence and exercise of corporate functions. A private citizen, whose rights are not invaded, and who has no cause of complaint, has no right to inquire collaterally into the legality of its existence. This can only be done in a direct proceeding on the part of the state, from whom is derived the right to exist as a corporation, and whose authority is usurped. This principle was clearly and emphatically declared in *Lehman v. Warner*, 61 Ala. 455, in the following language: "The corporation must of necessity be presumed to be rightfully in possession of the franchise, and rightfully to exercise the power which the legislative grant confers. Individual right is not invaded, if the negative is true in fact, and there is usurpation. It is the state—the sovereign—whose rights are invaded and whose authority is usurped. The individual could not create the corporation, could not grant, define, limit its powers, and no grant of these by the sovereign can lessen his rights. There can consequently be no cause of complaint by the citizen, and no right to inquire whether corporate existence is rightful *de jure*, or merely colorable." *Taylor, Corp.* § 145; 4 Amer. & Eng. Enc. Law, 198. The creditor cannot proceed against the stockholders as partners, without proving non-compliance with prescribed conditions precedent, thus inquiring collaterally, not into the fact, but the legality, of its existence.

It is also an established rule of general application, that a party who contracts with a corporation, exercising corporate powers and performing corporate functions, existing as a *de facto* corporation, in its corporate name and capacity, will not be permitted in a suit on the contract to deny and disprove the rightfulness of its existence. 4 Amer. & Eng. Enc. Law, 198. In *Swartwout v. Railroad Co.*, 24 Mich. 390, Cooley, J., declares the rule as follows: "Where there is thus a corporation *de facto*, with no want of legislative power to its due and legal

existence, when it is proceeding in the performance of corporate functions, and the public are dealing with it on the supposition that it is what it professes to be, and the questions are only whether there has been exact regularity and strict compliance with the provisions of the law relating to corporations, it is plainly a dictate alike of justice and public policy, that, in controversies between the de facto corporation and those who have entered into contract relations with it, as corporators or otherwise, such questions should not be suffered to be raised."

The general rule is thus stated by Brickell, C. J.: "Whoever contracts with a corporation in the use of corporate powers and franchises, and within the scope of such powers, is estopped from denying the existence of the corporation, or inquiring into the regularity of the corporate organization, when an enforcement of the contract, or of rights arising under it, is sought." *Cahall v. Association*, 61 Ala. 232; *Central A. & M. Ass'n v. Alabama G. L. Ins. Co.*, 70 Ala. 120; *Schloss v. Trade Co.*, 87 Ala. 411, 6 South. 360, 13 Am. St. Rep. 51.

It is conceded that the rule has been invoked and applied most frequently in suits against the stockholders or corporation, or persons who have contracted with it, where the stockholder, or corporation, or person, is seeking to avoid a liability by denying the legality of the corporate organization. But why should it not be applicable in other cases? Why should the stockholder be estopped in a suit by a creditor of an insolvent corporation to require payment of his unpaid subscription, and the creditor allowed to ignore the existence of the corporation, and proceed against the stockholder as a partner? Why should not the estoppel be mutual? Taylor, in his work on Corporations, § 148, having stated the general rule, that a corporation, when sued on its contract, and the person who contracted with it, when sued on his contract, is estopped to deny its legal incorporation, adds: "Furthermore, persons who have contracted with a corporation as such, and have acquired claims against it, are estopped from denying its corporate existence for the purpose of holding its shareholders liable as partners." And the same rule was applied in several of the cases cited above, in which a corporate creditor was seeking to hold the stockholder liable as a partner for a corporate debt. The abrogation of the foregoing well-established rule is the logical sequence of maintaining a suit by a creditor of a de facto corporation, charging the stockholders as partners.

Another consideration. Section 8, art. 14, of the constitution, declares: "In no case shall any stockholder be individually liable otherwise than for the unpaid stock owned by him or her." Exemption from liability other than for unpaid stock is the declared policy of the state. It cannot be imposed by legislation or by the judgment of a court. In view of the constitutional provision it is manifest that the shareholders of the Dispatch Publishing Company intended, by the attempt to incorporate, to avoid individual liability for the debts contracted by the corporation. When a party deals and contracts with a

corporation as corporators, exemption from individual liability enters as an element of the contract. It is true that the liability of persons associated in an enterprise or adventure is not determinable by the name they may assume, but by the legal consequences of their acts. A partnership may arise as to third persons by mere operation of law, and contrary to the intention of the parties, but, to have the effect, the elements essential to constitute a partnership as to third persons must exist. A corporation de facto has an independent status, recognized by the law as distinct from that of its members. A partnership is not the necessary legal consequence of an abortive attempt at incorporation. As said in *Fay v. Noble*, supra: "Surely, it cannot be, in the absence of all fraudulent intent, that such a legal result follows as to fasten on parties involuntarily, for such a cause, the enlarged liability of copartners, a liability neither contemplated nor assented to by them. The statement of the proposition carries with it a sufficient refutation."

Maintenance of such suit involves judicial nullification of franchises and powers enjoyed and exercised by a de facto corporation as a distinct entity recognized by the law, acquiesced in by the state; defeats the corporate character of the contract; changes the relation from that of stockholders to that of partners; substitutes other and new parties to the contract; effects the imposition of an enlarged liability, which they did not assume, but intended to avoid, so understood by the creditor when he contracted the debt with the corporation as such. The contract is valid and binding on the corporation, which the creditor trusted. No injustice is done him for all his rights and remedies are preserved by the principle, that the corporation and the shareholder are estopped from denying its legal existence, as against him. It will not answer to say that he is not repudiating, but enforcing, the contract. He repudiates the party, the corporation, with which he made the contract, and seeks its enforcement against parties who never entered into contractual relation with him. The doctrine that a creditor who has dealt with a de facto corporation in its corporate capacity cannot charge the stockholders as partners with the corporate debt, there being no fraudulent intent alleged and proved, seems to us to be sustained by the weight of authority, maintained by stronger reasoning consistent with well-settled principles, and in harmony with the policy of the state. Affirmed.



### III. Liability of Associates as Partners <sup>5</sup>

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#### HARRILL v. DAVIS.

(United States Circuit Court of Appeals, Eighth Circuit, 1909. 168 Fed. 187, 94 C. C. A. 47, 22 L. R. A. [N. S.] 1153.)

In Error to the United States Court of Appeals in the Indian Territory.

The Western Investment Company brought this action for a balance due it upon an account for lumber and materials sold, cotton handled, and services rendered to Walter B. Mann, Frank M. Davis, Robert S. Davis, and James G. Knight, as partners doing business under the firm name the "Coweta Cotton & Milling Company." The defendants denied the partnership and their liability, and averred that the indebtedness in question was that of the milling company and that that company was a corporation. The evidence established these facts: One Naylor was the president, and Frank M. Davis was the vice president and general manager, and Naylor, Davis, Edwards, and Wallace were directors, of the Western Investment Company. There were 1,000 shares of the capital stock of that company, of which Naylor owned 520, Davis, Edwards, and Wallace 80 each.

In April or June, 1902, Mann, Frank M. Davis, Robert S. Davis, and Knight agreed to embark in a \$10,000 enterprise for the purpose of building a cotton gin, buying, ginning, and selling cotton, that Mann should take two-fifths of this undertaking and the other three members one-fifth each, and that Frank M. Davis should take his fifth for the Western Investment Company. Neither the Western Investment Company nor any of its directors ever authorized Davis to take this stock on its behalf, and he never reported to the company that he had so taken it until January, 1903, after the indebtedness here in question had been incurred, and at about the time when the milling company ceased to operate its gin. He testified that he had some conversation with Edwards and Wallace about his taking this stock for the corporation, but that he never mentioned it to Naylor, the president, who held a majority of the stock. In February, 1903, after the milling company had ceased to operate its gin, Davis caused an entry of a credit of \$1,150 to that company to be entered upon the account books of the investment company on account of this stock, and the investment company subsequently repudiated this charge and charged the \$1,150 back to the milling company.

<sup>5</sup> For discussion of principles, see Clark on Corp. (3d Ed.) § 45.

In April or June, 1902, F. M. Davis, on behalf of the investment company, agreed with the other defendants to furnish to them materials to build the cotton gin, and in June or the following month the plaintiff commenced to furnish materials and to render its services for this purpose, which were received by Knight as the representative of the defendants and used by him to construct the cotton gin and to carry on the business which the defendants were conducting. The price of these materials and services were charged upon the books of the investment company to Coweta Gin Company and the Coweta Gin cotton account.

On September 3, 1902, three of the defendants met and signed articles of incorporation as the "Coweta Cotton & Milling Company" and a declaration of the purpose of the incorporation, which the statutes required to be verified by the signers and to be filed with the clerk of the Court of Appeals and with the clerk of the judicial district in which the contemplated corporation was to do business. This declaration was verified by Mann on November 10, 1902, and by Frank M. Davis on December 10, 1902, and it was filed with the clerk of the Court of Appeals on December 22, 1902, and it was never filed elsewhere. The balance of indebtedness due to the investment company is about \$5,000 and interest, and all of it but a few hundred dollars was incurred before the articles of incorporation were filed. Frank M. Davis, as general manager of the investment company, treated the milling company as a corporation all the time during which this indebtedness was contracted, and never charged any of it to himself or his associates. He and other witnesses testified that the milling company received the benefit of all materials and services furnished by the plaintiff, and that the defendants received no benefit from them, and that they acted in good faith and without any intent to deceive or defraud any one. The entire amount of money paid into the milling company by the incorporators was not more than \$4,950. That company never had any stock book and never issued any stock. The defendants commenced to buy cotton and to operate their gin under the name of the milling company in October, 1902, and they ceased to operate their cotton gin in January, 1903. Knight managed the construction of the cotton gin and the other improvements for the defendants and the business of the defendants and the milling company from June, 1902, when he commenced the buildings, until January, 1903. About \$3,000 of the claim in suit was for lumber and labor furnished, and for this amount the investment company filed a claim for a mechanic's lien verified by the successor of Frank M. Davis in May, 1903, in which there is a statement that the milling company is a corporation. Upon this state of facts the trial court directed a verdict for the defendants, and refused to instruct the jury that the plaintiff was entitled to recover the por-

tion of the debt incurred prior to the filing of the articles of incorporation on December 22, 1902.

Before SANBORN and VAN DEVANTER, Circuit Judges, and W. H. MUNGER, District Judge.

SANBORN, Circuit Judge <sup>6</sup> (after stating the facts as above). The patent and indisputable facts in this case are that the four defendants associated themselves together, and from June, 1902, until December 22, 1902, actively engaged in purchasing lumber, material, and labor of the plaintiff, and in constructing a cotton gin under the name "The Coweta Gin Company," and in conducting the business of buying, selling, and ginning cotton for profit under the name "The Coweta Cotton & Milling Company," and that during this time they incurred more than \$4,700 of the indebtedness of \$5,145.48 for which this action was brought. On December 22, 1902, they made their first real attempt to incorporate, and for the first time took on the color or appearance of a corporation. On that day they filed articles of incorporation with the clerk of the Court of Appeals, but they never filed any duplicate of them with the clerk of the judicial district in which their place of business was located, as required by the statutes in order to constitute them a legal corporation and to authorize them to do business as such. Act Feb. 18, 1901, c. 379, 31 Stat. 794; Mansfield's Dig. Laws Ark. §§ 960, 968, 979.

The general rule is that parties who associate themselves together and actively engage in business for profit under any name are liable as partners for the debts they incur under that name. It is an exception to this rule that such associates may escape individual liability for such debts by a compliance with incorporation laws or by a real attempt to comply with them which gives the color of a legal corporation, and by the user of the franchise of such a corporation in the honest belief that it is duly incorporated. When the fact appears, as it does in the case at bar, by indisputable evidence that parties associated and knowingly incurred liabilities under a given name, the legal presumption is that they are governed by the general rule, and the burden is upon them to prove that they fall under some exception to it. *Owen v. Shepard*, 59 Fed. 746, 8 C. C. A. 244; *Wechselberg v. Flour City National Bank*, 64 Fed. 90, 94, 12 C. C. A. 56, 60, 61, 26 L. R. A. 470; *Clark v. Jones*, 87 Ala. 474, 6 South. 362.

Counsel for the defendants argue with much force and persuasiveness that they escape liability because they became a corporation de facto, although they concede that they never became a corporation de jure, and in support of this position they cite, among other cases: *Wells Co. v. Gastonia Cotton Mfg. Co.*, 198 U. S. 177, 25 Sup. Ct. 640, 49 L. Ed. 1003; *Andes v. Ely*, 158 U. S. 312, 322, 15 Sup. Ct. 954, 39 L. Ed. 996; *New Orleans Debenture Redemption Co. v. Louisiana*, 180 U. S. 320, 327, 21 Sup. Ct. 378, 45 L. Ed. 550; *Gart-*

<sup>6</sup> A portion of the opinion is omitted.



side Coal Co. v. Maxwell (C. C.) 22 Fed. 197; Johnson v. Okerstrom, 70 Minn. 303, 73 N. W. 147; Tennessee Automatic Lighting Co. v. Massey (Tenn. Ch. App.) 56 S. W. 35; Finnegan v. Noerenberg, 52 Minn. 239, 53 N. W. 1150, 18 L. R. A. 778, 38 Am. St. Rep. 552; Doty v. Patterson, 155 Ind. 60, 56 N. E. 668; Merchants' National Bank v. Stone, 38 Mich. 779; Gow v. Collin Lumber Co., 109 Mich. 45, 66 N. W. 676, 678; Eaton v. Aspinwall, 19 N. Y. 119; Leonardsville Bank v. Willard, 25 N. Y. 574; Cahall v. Citizens' Mutual Bldg. Ass'n, 61 Ala. 232; Fay v. Noble, 7 Cush. (Mass.) 188, 192, 193; Snider Sons' Co. v. Troy, 91 Ala. 224, 8 South. 658, 11 L. R. A. 515, 24 Am. St. Rep. 887; Cochran v. Arnold, 58 Pa. 399, 404; Laflin & Rand Powder Co. v. Sinsheimer, 46 Md. 315, 321, 24 Am. Rep. 522; Rutherford v. Hill, 22 Or. 218, 29 Pac. 546, 17 L. R. A. 549, 29 Am. St. Rep. 596. But in every one of these authorities articles of incorporation had been filed under a general enabling act, or a charter had been issued and there had been a user of the franchise of the supposed corporation which had been colorably created by the filing of the articles or the issue of the charter before the indebtedness in question was created, while nothing of this nature had been done before the debt for the \$4,700 which we are now considering was incurred. The authorities which have been recited rest upon the proposition that where parties procure a charter or file articles of association under a general law, thereby secure the color of a legal incorporation, believe that they are a corporation, and use the supposed franchise of the corporation in good faith, and third parties deal with them as a corporation, they become a corporation de facto and exempt from individual liability to such third parties, although there are unknown defects in the proceedings for their incorporation.

The statement of Morawetz on Corporations, at section 748, upon which counsel seem to rely, that "if an association assumes to enter into a contract in a corporate capacity, and the party dealing with the association contracts with it as if it were a corporation, the individual members of the association cannot be charged as parties to the contract, either severally or jointly, or as partners. This is equally true whether the association was in fact a corporation or not, and whether the contract with the association in its corporate capacity was authorized by the Legislature or prohibited by law, or illegal," is too broad to be sound. Parties who actively engage in business for profit under the name and pretense of a corporation which they know neither exists nor has any color of existence may not escape individual liability because strangers are led by their pretense to contract with their pretended entity as a corporation. In such cases they act as the agents of a principal that they know does not exist, and they are liable under a familiar rule, because there is no responsible principal. 2 Kent's Commentaries (14th Ed.) 630; Queen City Fur-

niture & Carpet Co. v. Crawford, 127 Mo. 356, 364, 30 S. W. 163. The burden is not on the strangers who deal with them as a corporation, but on themselves who act under the name of a pretended corporation, to see that it is so organized that it exempts them from individual liability, and if they fail in this they must pay the liabilities they incur, even in the absence of fraud or bad faith, upon the salutary principle that where one of two parties must suffer he must bear the loss whose breach of duty caused it.

There are cases in which stockholders who took no active part in the business of a pretended corporation which was acting without any charter or filed articles, who supposed that the corporation was duly organized, have been held exempt from individual liability for the debts it incurred; but if they had been actively conducting its business with knowledge of its lack of incorporation, those decisions must have been otherwise. *Seacord v. Pendleton*, 55 Hun, 579, 9 N. Y. Supp. 46; *Fuller v. Rowe*, 57 N. Y. 23, 26.

Neither the hope, the belief, nor the statement by parties that they are incorporated, nor the signing of articles of incorporation which are not filed, where filing is requisite to create the corporation nor the user of the pretended franchise of such a nonexistent corporation, will constitute such a corporation *de facto* as will exempt those who actively and knowingly use its name to incur obligations from their individual liability to pay them. Color of legal organization as a corporation under some charter or law and user of the supposed corporate franchise in good faith are indispensable to such exemption.

Under the general law of Arkansas in force in the Indian Territory, the filing of articles of incorporation with the clerk of the Court of Appeals was a *sine qua non* of any color of a legal corporation. Without that there was not, and there could not be, an apparent corporation or the color of a corporation. Agreements to form one, statements that there was one, signed articles of association to make one, acts as one, created no color of incorporation, because there could be no incorporation or color of it under the law until the articles were filed. *Johnson v. Corser*, 34 Minn. 355, 25 N. W. 799; *Finnegan v. Noerenberg*, 52 Minn. 239, 243, 244, 53 N. W. 1150, 1151, 18 L. R. A. 778, 38 Am. St. Rep. 552; *Taylor on Private Corporations*, p. 145; *Roberts Mfg. Co. v. Schlick*, 62 Minn. 332, 64 N. W. 826. In *Finnegan v. Noerenberg*, *supra*, Chief Justice Gilfillan well said: "To give to a body of men assuming to act as a corporation, where there has been no attempt to comply with the provisions of any law authorizing them to become such, the status of a *de facto* corporation, might open the door to frauds upon the public. It would certainly be impolitic to permit a number of men to have the status of a corporation to any extent merely because there is a law under which they might have become incorporated, and they have agreed among themselves

to act, and they have acted, as a corporation. That was the condition in *Johnson v. Corser*, 34 Minn. 355, 25 N. W. 799, in which it was held that what had been done was ineffectual to limit the individual liability of the associates. They had not gone far enough to become a de facto corporation. They had merely signed articles, but had not attempted to give them publicity by filing for record, which the statute required."

The defendants cannot escape individual liability for the \$4,700 on the ground that the Coweta Cotton & Milling Company was a corporation de facto when that portion of the plaintiff's claim was incurred, because it then had no color of incorporation, and they knew it and yet actively used its name to incur the obligation. *Owen v. Shepard*, 8 C. C. A. 244, 59 Fed. 746; *Wechselberg v. Flour City National Bank*, 64 Fed. 90, 94, 12 C. C. A. 56, 60, 61, 26 L. R. A. 470; *Abbott v. Omaha Smelting & Refining Co.*, 4 Neb. 416, 423, 424; *Garnett v. Richardson*, 35 Ark. 144; *Johnson v. Corser*, 34 Minn. 355, 357, 25 N. W. 799; *Queen City Furniture & Carpet Co. v. Crawford*, 127 Mo. 356, 364, 30 S. W. 163; *Bigelow v. Gregory*, 73 Ill. 197, 202; *Parsons on Partnership*, p. 544; *Hill v. Beach*, 12 N. J. Eq. 31; *Kaiser v. Lawrence Savings Bank*, 56 Iowa, 104, 8 N. W. 772, 41 Am. St. Rep. 85; *Pettis v. Atkins*, 60 Ill. 454; *Coleman v. Coleman*, 78 Ind. 344; *Lawler v. Murphy*, 58 Conn. 313, 20 Atl. 457, 8 L. R. A. 113; *Hurt v. Salisbury*, 55 Mo. 310, 314; *Beach on Private Corporations*, § 16, p. 25; *Martin v. Fewell*, 79 Mo. 401, 411; *Smith v. Warden*, 86 Mo. 382, 399; *McVicker v. Cone*, 21 Or. 353, 28 Pac. 77. \* \* \*

Counsel insist that the defendants are not liable here because one who deals with a corporation de facto is estopped from denying its existence as a corporation; but the true meaning and legal effect of this rule is that such a dealer is estopped from denying its existence on the ground that it was not legally incorporated. One who deals with parties who masquerade under a name which represents no corporation de facto is no more estopped from denying that it is a corporation than he would be from denying that they constituted or acted for the Union Pacific Railroad Company, or any other well-known corporation, when they did not. The fact that the plaintiff dealt with and treated the Coweta Cotton & Milling Company as a corporation did not estop it from denying that it was such before the defendants filed their articles of incorporation, because it was not a corporation de facto before that time and because the indispensable elements of an estoppel in pais, ignorance of the truth and absence of equal means of knowledge of it by the party who claims the estoppel, and action by the latter induced by the misrepresentation of the party against whom the estoppel is invoked, do not exist in the case at bar. *Bigelow on Estoppel* (4th Ed.) p. 679. The plaintiffs did not, and the defendants did, represent that the milling company was a corporation when it was not. The defendants had better means of knowledge of the fact than the



plaintiff, and they knew it was not a corporation, and they were not induced to act on any representation of the plaintiff that it was such, or by its treatment of it as such.

Nor was the plaintiff estopped by the fact that its general manager stated under oath in its claim for a lien in May, 1903, that the milling company was a corporation, first, because the defendants were not induced to take any action by this statement from which they can suffer any injury by the proof of the truth; and, second, because one is not estopped from pursuing his true legal remedy by a mistaken attempt to pursue a supposed remedy that does not exist. *Standard Oil Co. v. Hawkins*, 20 C. C. A. 468, 472, 74 Fed. 395, 398, 399, 33 L. R. A. 739; *Barnsdall v. Waltemeyer*, 73 C. C. A. 515, 520, 142 Fed. 415, 420; *Bunch v. Grave*, 111 Ind. 351, 12 N. E. 514, 517.

It is said that the plaintiff is estopped from denying the existence of the defendant's supposed corporation because it was one of its promoters and stockholders, but the evidence fails to convince us that it was ever either. F. M. Davis was the general manager of the plaintiff. He testified that in June, 1902, he agreed with the other defendants to take a \$2,000 share for the plaintiff in a corporation to be organized with a capital of \$10,000 for the purpose of ginning and dealing in cotton, that Mann agreed to take a \$4,000 share, R. S. Davis and James G. Knight a share of \$2,000 each, that in September he signed the articles of incorporation and subscribed for this stock, that the other defendants also subscribed, that these subscribers paid the first assessment of \$3,750 on \$10,000 of the stock in the fall of 1902, that the second assessment of \$2,000 was made in January, 1903, that he never reported this stock to the plaintiff until January, 1903, but that in the summer and fall of 1902 he talked with Edwards and Wallace, two of the directors, who had 80 shares of stock each in the plaintiff, about this stock which he was to take and which he had taken, that the plaintiff and they acquiesced in his action and told him to do the best he could with it, but that they did not direct or instruct him to take the stock or agree that he should take it, and that he did not talk with the president, who was the owner of the majority of the stock of the plaintiff, although another witness testified that some time in the fall of 1902 he told Naylor that Davis had taken stock in the milling company for the plaintiff. Davis, however, subscribed for the stock in his own name, and the plaintiff did not. He testified that he paid the first assessment in the fall of 1902, but he never charged the plaintiff and credited himself with that payment; but, on the contrary, on February 23, 1903, after the milling company had ceased to operate its gin, he caused an entry to be made on the books of the investment company charging it and crediting the milling company with \$1,150, the amount of the two assessments on his stock, an entry which the plaintiff subsequently repudiated. There are two reasons why, under the evidence in this record, the plaintiff never became a holder, either in law or in equity, of any share in the defendant's enterprise or com-

pany, either as a stockholder or otherwise. In the first place, the construction and operation of a cotton gin was beyond the powers of the plaintiff corporation, the nature of whose business was declared and limited by its articles to "buying, selling, leasing and dealing in lands, securities, bonds, notes, stocks and other negotiable paper, and also buying and selling general merchandise." In the second place, if by any conceivable interpretation the construction and operation of a cotton gin and the formation of the corporation, and the taking of stock therein to accomplish that purpose, could be deemed to be within the powers of this corporation, they are so far beyond the scope of its ordinary business that a general manager could be authorized to commit his corporation to them only by the express authority of its board of directors, or of its principal officers, after a full disclosure to them of all the facts relating to the proposed enterprise, and the desultory talks which Davis had with the two directors fall far short of any evidence of such authority.

Much is made in argument of the testimony of Davis and Knight that they acted in good faith, that the defendants never received any benefit from the materials and labor for the purchase price of which the plaintiff sues, but good faith and the use of a name which they know represents no corporation as the name of a corporation under which they do business creates a partnership, and neither a corporation *de jure* nor *de facto*. And the defendants had all the benefit there was from the materials and labor furnished by the plaintiff, for the milling company never issued any stock, and these defendants owned their respective shares in its property, and whatever it had they had, and, as far as they have not disposed of it, they still have. The fact is that during this entire transaction while Davis was the general manager of the plaintiff he was the partner of the defendants, and, in all transactions between the plaintiff and the defendants, was pecuniarily interested adversely to his principal.

The sum of the whole matter is that the defendants agreed in April or June, 1902, to take certain shares in a \$10,000 enterprise for the purpose of building a cotton gin, and buying, ginning, and selling cotton, and to organize a corporation to carry on this business they bought between June and December 22, 1902, materials and labor with which they built the cotton gin, and between September 15th and December 22d operated their cotton gin and carried on the business of buying, ginning, and selling cotton with the plaintiff to the amount of several tens of thousands of dollars, and there remains a balance of about \$4,700 due the plaintiff on this account. They never issued any stock, but in September, November, and December they signed articles of incorporation which they filed with the clerk of the Court of Appeals on December 22, 1902. During this time they treated themselves and the plaintiff dealt with them as a corporation. They represented themselves to be a corporation when they knew they were not; under the

name of a corporation which did not exist they purchased these goods and services.

And our conclusion is that the defendants never became a corporation de facto prior to December 22, 1902, that they never became a corporation de jure, that the indebtedness here in question was not incurred under any promise or assurance of the defendants as promoters that it should become the obligation of a corporation to be formed, that a large part of it was incurred in the conduct of a general commercial business, and not to prepare for the commencement of such a business or for the organization of a corporation, and that the trial court below should have instructed the jury that the defendants were individually liable for that portion of the plaintiff's claim which was incurred prior to December 22, 1902. Its failure to do so was a fatal error which necessitates a reversal of the judgments below.

In view of the conclusion which has now been reached, it is unnecessary to discuss at length or to determine other questions which are presented in this record. It is sufficient to say regarding the portion of the plaintiff's claim incurred subsequent to December 22, 1902, that while there is a conflict of authority upon the question whether or not incorporators or stockholders remain personally liable after the filing of articles in one office only where the statute requires them to be filed in two offices as a condition of incorporation or of the commencement of business (Mokelumne Hill Canal & Mining Co. v. Woodbury, 14 Cal. 265, 267), the statute under which this case arose was brought into the Indian Territory from the state of Arkansas, and the Supreme Court of that state had held, before it was adopted in the Indian Territory, that such corporators or stockholders remain individually liable under this statute unless and until their articles of incorporation are filed in both offices. Garnett v. Richardson, 35 Ark. 144. This conclusion is sustained by eminent authority (Wechselberg v. Flour City National Bank, 12 C. C. A. 56, 60, 61, 64 Fed. 90, 94, 26 L. R. A. 470, and authorities there cited), and it is an established rule of statutory construction that the adoption of a statute previously in force in some other jurisdiction is presumed to be the adoption of the interpretation thereof which had been theretofore placed upon it by the judicial tribunal whose duty it was to construe it. Black, Interpretation of Laws, p. 159, § 70; McDonald v. Hovey, 110 U. S. 619, 628, 4 Sup. Ct. 142, 28 L. Ed. 269; Sanger v. Flow, 1 C. C. A. 56, 58, 48 Fed. 152, 154; Blaylock v. Incorporated Town of Muskogee, 54 C. C. A. 639, 117 Fed. 125.

The judgments of the courts below must be reversed, and the case must be remanded to the proper court for a new trial; and it is so ordered.



## RELATION BETWEEN CORPORATION AND ITS PROMOTERS

### I. Liability of Corporation for Expenses and Services of Promoters<sup>1</sup>

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#### CUSHION HEEL SHOE CO. v. HARTT.

(Supreme Court of Indiana, 1914. 181 Ind. 167, 103 N. E. 1063, 50 L. R. A. [N. S.] 979.)

Appeal from Superior Court, Allen County; E. O'Rourke, Special Judge.

Action by Obder M. Hartt against the Cushion Heel Shoe Company. Judgment for plaintiff, and defendant appeals. Reversed.

Transferred from Appellate Court under Burns' Ann. St. 1908, § 1405.

SPENCER, J. It appears from the record in this case that in April, 1909, appellee, who was experienced in the manufacture of shoes, inserted in a shoe journal an advertisement for a shoe factory to locate in the city of Ft. Wayne. Among the answers which he received there-to was one from a man named Johnson, who was the patentee of a certain cushion heel shoe. Johnson came to Ft. Wayne, and with him appellee went to the president of the Commercial Club whom they interested in the proposition of starting appellant company. Subscription lists were prepared and appellee started out to get subscribers to the undertaking. He testified that Johnson then promised him the position of superintendent when the factory should be established, and also promised that he (appellee) should be paid for his time and money spent in securing the stock subscriptions; that after the company was organized appellee talked with several of the directors and officers of appellant company and told them that he expected to be paid for his services; that one of the directors said to appellee: "I believe you should be compensated. I have told the people, the directors, to settle with you." No testimony was introduced to show that the board of directors ever acted on appellee's claim, but it is his contention that, by accepting the results of his services and receiving the benefits thereof, appellant is now bound on an implied contract to pay for such service.

It is certain that, under ordinary circumstances, a corporation cannot be successfully sued on a contract made for its benefit by its projectors before its incorporation. Contracts of this character, however, are not void, but voidable, and it is well settled in nearly all jurisdictions

<sup>1</sup> For discussion of principles, see Clark on Corp. (3d Ed.) § 46B.

that, in so far as they are not ultra vires, such contracts may become binding on the corporation if ratified by it, either expressly or by implication, after its organization. *Smith v. Parker*, 148 Ind. 127-133, 45 N. E. 770; *Bruner v. Brown*, 139 Ind. 600-602, 38 N. E. 318; *Davis & Rankin, etc., Co. v. Hillsboro Creamery Co.*, 10 Ind. App. 42, 37 N. E. 549; *Tuttle v. Tuttle*, 101 Me. 287-292, 64 Atl. 496, 8 Ann. Cas. 260; *Battelle v. Northwestern, etc., Co.*, 37 Minn. 89, 33 N. W. 327.

But the rule that a corporation may be bound, like any individual, by an implied contract is limited in its application to contracts in which the promoters of such corporation are interested. The law does not prohibit a promoter from dealing with his company, and a corporation has the right to purchase property from its promoters and to pay them for their services if it so elects; but the burden is on the promoter to show that he acts openly and in good faith in such transactions. A promoter of a corporation, who brings about its organization and aids in securing subscriptions thereto, is considered in law as occupying a fiduciary relationship toward such corporation and toward its stockholders. *Chandler v. Bacon* (C. C.) 30 Fed. 538, 539; *Bosher v. R. & H. Land Co.*, 89 Va. 455-461, 16 S. E. 360, 37 Am. St. Rep. 879; *Plaquemines, etc., Co. v. Buck*, 52 N. J. Eq. 219-240, 27 Atl. 1094; *Burbank v. Dennis*, 101 Cal. 90-97, 35 Pac. 444; *Yale Gas Stove Co. v. Wilcox*, 64 Conn. 101, 29 Atl. 303, 25 L. R. A. 90, 42 Am. St. Rep. 159. It will be observed that this relationship is two-fold. It extends toward the corporation as a separate legal entity and charges the promoter with fair dealing in respect to corporate property. *Central Land Co. v. Obenchain*, 92 Va. 130, 22 S. E. 876; *South Joplin Land Co. v. Case*, 104 Mo. 572-578, 16 S. W. 390; *Hayden v. Green*, 66 Kan. 204, 71 Pac. 236; *Old Dominion, etc., Co. v. Bigelow*, 188 Mass. 315, 74 N. E. 653, 108 Am. St. Rep. 479; *Tegarden v. Big Star Zinc Co.*, 71 Ark. 277, 72 S. W. 989. It extends also toward the stockholders in respect to their property rights in their stock and toward those who, it is expected, will buy such stock. *Dickerman v. Northern Trust Co.*, 176 U. S. 181, 20 Sup. Ct. 311, 44 L. Ed. 423; *Walker v. Pike County Land Co.*, 139 Fed. 609, 71 C. C. A. 593; *Hayward v. Leeson*, 176 Mass. 310, 57 N. E. 656, 49 L. R. A. 725; *Goodwin v. Wilbur*, 104 Ill. App. 45; *New York, etc., R. Co. v. Ketchum*, 27 Conn. 170; *Colton Imp. Co. v. Richter*, 26 Misc. Rep. 26, 55 N. Y. Supp. 486; *Fred Macey Co. v. Macey*, 143 Mich. 139, 106 N. W. 722, 5 L. R. A. (N. S.) 1036; *Hinkley v. Sac, etc., Co.*, 132 Iowa, 396, 107 N. W. 629, 119 Am. St. Rep. 564.

Applying this latter rule, the Supreme Court of Massachusetts uses this language in *Hayward v. Leeson*, supra, 176 Mass. at page 320, 57 N. E. 661, 49 L. R. A. 725: "The persons to whom the promoters owe the duty, which they owe by reason of their fiduciary relation, are the persons who put their money into the enterprise at the invitation of the promoters, that is to say, the future stockholders. It is to the

future stockholders that the promoters must make the disclosure of the remuneration which is, or is to be, paid to them, and it is the consent of the future stockholders that must be obtained to make that payment valid; if the promoters undertake to make to themselves remuneration for their services as promoters, without making a full disclosure of the fact to the future stockholders, their principals, and getting their consent, they are guilty of a fraud. Promoters can make the necessary disclosure of the remuneration they stipulate for by including in the prospectus a full statement thereof; if such a statement is not made therein, they cannot honestly take any remuneration for promoters' services, unless it is voted by the stockholders after the capital stock has been taken by the public."

In the case of *New York, etc., R. Co. v. Ketchum*, supra, 27 Conn. at page 179, the court said: "We are aware that it is no uncommon practice for corporations to assume and pay these preliminary \* \* \* charges, after the company has become organized, but we do not see how the company, if it should object, could be compelled to pay them, and in some cases it would be most inequitable to require it. Can a few persons combine for their own interest to get up a railroad, agree with one of their number to give him a large commission or bonus for every stockholder he can allure into the company, and privately make this commission or bonus a charge on the corporation when formed? This would be a breach of faith towards honest and unsuspecting stockholders who pay the charter price for their stock and expect to take it clear of all incumbrance. \* \* \* It is soon enough for corporate bodies to enter into contracts incumbering their property when they are duly organized according to their charters and have their chosen and impartial directors to conduct their business."

In *Rockford, etc., R. Co. v. Sage*, 65 Ill. 328-332 (16 Am. Rep. 587), the court held that it was "unjust to stockholders, who subscribe and pay for stock in a company, that their property should be subject to the incumbrance of such claims, and which they had no voice in creating." See, also, *Tuttle v. Tuttle*, 101 Me. 287-292, 64 Atl. 496, 8 Ann. Cas. 260, and cases cited; *Marchand v. Loan & Pledge Ass'n*, 26 La. Ann. 389; 1 *Thompson on Corporations* (2d Ed.) § 88; 10 Cyc. 264, pt. 77.

We are aware that cases may be found which seem to sustain appellee's position, but, as is suggested in 10 Cyc. at page 265, "it is difficult to understand how the corporation could be estopped by accepting benefits which it had no power to reject, without uncreating itself." We believe that the better reason and the weight of authority support the holding that, in the absence of statutory or charter provisions, a corporation will be held liable for services rendered by its promoters before incorporating only when, by express action taken after it has become a legal entity, it recognizes or affirms such claim. The evidence before us does not indicate such an affirmance. In *Tift v. Quaker City National Bank*, 141 Pa. 550, 21 Atl. 660, as in this case, it was shown that the plaintiff's claim was brought to the attention of the



board of directors after the defendant's incorporation, but that no action was taken thereon. The court held that "mere silence of the board of directors, or failure to object when the claim was mentioned, is not such an act of ratification as will bind the bank."

Judgment reversed.

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## II. Liability on Contracts by Promoters<sup>2</sup>

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KELNER v. BAXTER et al.

(Court of Common Pleas, 1866. L. R. 2 C. P. Cas. 174.)

At the trial before Erle, C. J., at the sittings in London after last Trinity term, the following facts appeared in evidence: The plaintiff was a wine merchant, and the proprietor of the Assembly Rooms at Gravesend. In August, 1865, it was proposed that a company should be formed for establishing a joint-stock hotel company at Gravesend, to be called the Gravesend Royal Alexandra Hotel Company, Limited, of which the following gentlemen were to be the directors, viz.: Mr. L. Calisher, Mr. T. H. Edmands, Mr. M. Davis, Mr. Macdonald, Mr. Hulse, Mr. N. J. Calisher (one of the defendants), and the plaintiff. The plaintiff was to be manager of the proposed company; and Mr. Dales (another of the defendants) was to be the permanent architect. One part of the scheme was that the company should purchase the premises of the plaintiff for a sum of £5000, of which £3000 was to be paid in cash, and £2000 in paid-up shares, the stock, etc., to be taken at a valuation; and this was carried into effect and completed, the other defendant (Baxter) being the nominal purchaser on behalf of the company. In December a prospectus was settled. On the 9th of January, 1866, a memorandum of association was executed by the plaintiff and the defendants and others.

Pending the negotiations the business had been carried on by the plaintiff, and for that purpose additional stock had been purchased by him; and on the 27th of January, 1866, an agreement was entered into for the transfer of this additional stock to the company, in the following terms:

"January 27th, 1866.

"To John Dacier Baxter, Nathan Jacob Calisher, and John Dales, on behalf of the proposed Gravesend Royal Alexandra Hotel Company, Limited—Gentlemen: I hereby propose to sell the extra stock now at the Assembly Rooms, Gravesend, as per schedule hereto, for the sum of £900, payable on the 28th of February, 1866.

"[Signed]

John Kelner."

<sup>2</sup> For discussion of principles, see Clark on Corp. (3d Ed.) § 47.

Then followed a schedule of the stock of wines, etc., to be purchased, and at the end was written as follows:

"To Mr. John Kelner—Sir: We have received your offer to sell the extra stock as above, and hereby agree to and accept the terms proposed.

"[Signed]

J. D. Baxter,  
"N. J. Calisher,  
"J. Dales,

"On Behalf of the Gravesend Royal Alexandra Hotel Co., Limited."

In pursuance of this agreement the goods in question were handed over to the company, and consumed by them in the business of the hotel: and on the 1st of February a meeting of the directors took place, at which the following resolution was passed: "That the arrangement entered into by Messrs. Calisher, Dales, and Baxter, on behalf of the company, for the purchase of the additional stock on the premises, as per list taken by Mr. Bright, the secretary, and pointed out by Mr. Kelner, amounting to £900 be, and the same is hereby ratified." There was also a subsequent ratification by the company, viz. on the 11th day of April, but this was after the commencement of the action.

The articles of association of the company were duly stamped on the 13th of February, and on the 20th the company obtained a certificate of incorporation under the 25 & 26 Vict. c. 89.

The company having collapsed, the present action was brought against the defendants upon the agreement of the 27th of January.

On the part of the defendants oral evidence was tendered for the purpose of showing that it never was intended that they should be personally liable; but his Lordship rejected it. It was then submitted that, inasmuch as the agreement was not entered into by the defendants personally, but only as agents for the hotel company, they thereby incurred no personal obligation to the plaintiff, who was himself one of the promoters.

For the plaintiff it was insisted that, there being no company in existence at the time of the agreement, the parties thereto had rendered themselves personally liable; and that there could be no ratification of the contract by a subsequently created company.

A verdict was taken for the plaintiff for £900, subject to leave reserved to the defendants (upon giving security) to move to enter a nonsuit, on the ground that the agreement of the 27th of January did not make them personally liable.

ERLE, C. J. I am of opinion that this rule should be discharged. The action is for the price of goods sold and delivered: and the question is whether the goods were delivered to the defendants under a contract of sale. The alleged contract is in writing, and commences with a proposal addressed to the defendants, in these words: "I hereby propose to sell the extra stock now at the Assembly Rooms, Graves-

end, as per schedule hereto, for the sum of £900, payable on the 28th of February, 1866." Nothing can be more distinct than this as a vendor proposing to sell. It is signed by the plaintiff, and is followed by a schedule of the stock to be purchased. Then comes the other part of the agreement, signed by the defendants, in these words: "Sir, We have received your offer to sell the extra stock as above, and hereby agree to and accept the terms proposed." If it had rested there, no one could doubt that there was a distinct proposal by the vendor to sell, accepted by the purchasers. A difficulty had arisen because the plaintiff has at the head of the paper addressed it to the plaintiffs, "on behalf of the proposed Gravesend Royal Alexandra Hotel Company, Limited," and the defendants have repeated those words after their signatures to the document; and the question is, whether this constitutes any ambiguity on the face of the agreement, or prevents the defendants from being bound by it. I agree that if the Gravesend Royal Alexandra Hotel Company had been an existing company at this time, the persons who signed the agreement would have signed as agents of the company. But, as there was no company in existence at the time, the agreement would be wholly inoperative unless it were held to be binding on the defendants personally.

The cases referred to in the course of the argument fully bear out the proposition that, where a contract is signed by one who professes to be signing "as agent," but who has no principal existing at the time, and the contract would be altogether inoperative unless binding upon the person who signed it, he is bound thereby; and a stranger cannot by a subsequent ratification relieve him from that responsibility. When the company came afterwards into existence it was a totally new creature, having rights and obligations from that time, but no rights or obligations by reason of anything which might have been done before. It was once, indeed, thought that an inchoate liability might be incurred on behalf of a proposed company, which would become binding on it when subsequently formed: but that notion was manifestly contrary to the principles upon which the law of contract is founded. There must be two parties to a contract; and the rights and obligations which it creates cannot be transferred by one of them to a third person who was not in a condition to be bound by it at the time it was made. The history of this company makes this construction to my mind perfectly clear. It was no doubt the notion of all parties that success was certain: but the plaintiff parted with his stock upon the faith of the defendants' engagement that the price agreed on should be paid on the day named. It cannot be supposed that he for a moment contemplated that the payment was to be contingent on the formation of the company by the 28th of February. The paper expresses in terms a contract to buy. And it is a cardinal rule that no oral evidence shall be admitted to show an intention different from that which appears on the face of the writing.



I come, therefore, to the conclusion that the defendants, having no principal who was bound originally, or who could become so by a subsequent ratification, were themselves bound, and that the oral evidence offered is not admissible to contradict the written contract.

WILLES, J. I am of the same opinion. Evidence was clearly inadmissible to show that the parties contemplated that the liability on this contract should rest upon the company and not upon the persons contracting on behalf of the proposed company. The utmost it could amount to is, that both parties were satisfied at the time that all would go smoothly, and consequently that no liability would ensue to the defendants. The contract is, in substance, this, "I, the plaintiff, agree to sell to you, the defendants, on behalf of the Gravesend Royal Alexandra Hotel Company, my stock of wines;" and, "We, the defendants, have received your offer and agree to and accept the terms proposed, and you shall be paid on the 28th of February next." Who is to pay? The company, if it should be formed. But, if the company should not be formed, who is to pay? That is tested by the fact of the immediate delivery of the subject of sale. If payment was not made by the company, it must, if by anybody, be by the defendants. That brings one to consider whether the company could be legally liable. I apprehend the company could only become liable upon a new contract. It would require the assent of the plaintiff to discharge the defendants. Could the company become liable by a mere ratification? Clearly not. Ratification can only be by a person ascertained at the time of the act done—by a person in existence either actually or in contemplation of law; as in the case of assignees of bankrupts and administrators, whose title, for the protection of the estate, vests by relation. The case of an executor requires no such ratification, inasmuch as he takes from the will. It is unnecessary, however, to pursue this further. In addition to the cases cited at the bar, I would refer to *Gunn v. London and Lancashire Fire Insurance Company*, 12 C. B. N. S. 694 (E. C. L. R. vol. 104), where this Court, upon the authority of *Payne v. New South Wales Coal and International Steam Navigation Company*, 10 Ex. 283, 24 L. J. Ex. 117, held that a contract made between the projector and the directors of a joint-stock company provisionally registered, but not in terms made conditional on the completion of the company, was not binding upon the subsequent completely registered company, although ratified and confirmed by the deed of settlement: and Williams, J., said that, "to make a contract valid, there must be parties existing at the time who are capable of contracting." That is an authority of extreme importance upon this point; and, if ever there could be a ratification, it was in that case.

Both upon principle and upon authority, therefore, it seems to me that the company never could be liable upon this contract: and, as was put by my Lord, construing this document *ut res magis valeat quam pereat*, we must assume that the parties contemplated that the persons signing

it would be personally liable. Putting in the words "on behalf of the Gravesend Royal Alexandra Hotel Company" would operate no more than if a person should contract for a quantity of corn "on behalf of my horses." As to the suggestion that there should have been a special count, that is quite a mistake. There need not be a special count unless there was a person existing at the time the contract was made who might have been principal. The common count perfectly well represents the character of the liability which these defendants incurred. It is quite out of the question to suppose that there was any mistake. The document represents the real transaction between the parties. I think that the course taken at the trial was perfectly correct, and that the rule should be discharged.

Rule discharged.

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### KOPPEL v. MASSACHUSETTS BRICK CO.

(Supreme Judicial Court of Massachusetts, 1906. 192 Mass. 223, 78 N. E. 128.)

Appeal from Superior Court, Franklin County.

Action on a contract by Arthur Koppel against the Massachusetts Brick Company, to recover for goods and materials ordered of plaintiff on December 30, 1901, by one Welch, by whom they were transferred to the defendant on its incorporation, and for goods ordered by Welch as agent of the corporation after incorporation. From the judgment, plaintiff appeals. Affirmed.

KNOWLTON, C. J. This is an appeal by the plaintiff from a judgment of the superior court upon an agreed statement of facts, for a sum less than that claimed by him in his declaration. The defendant did not appeal, but says in its brief that "there is no error of law shown by the record." We therefore have no occasion to consider the last part of the account, on which the finding was for the plaintiff.

Upon a submission of an action on an agreed statement of facts, the decision is to be made upon the facts actually stated. In the absence of a stipulation that inferences may be drawn from the facts stated, the question is whether the matters agreed upon establish the plaintiff's case. Neither the superior court nor this court can draw inferences of fact either for or against the plaintiff. *Schwarz v. Boston*, 151 Mass. 226, 24 N. E. 41; *Mayhew v. Durfee*, 138 Mass. 584.

In this case the disputed items of the account are for articles ordered by one Welch and charged to him by the plaintiff. Afterwards a suit was brought against Welch by the plaintiff, to recover the price of them, and on his payment of \$1,000 to the plaintiff, a settlement was made and Welch was given a release of all demands, without prejudice to the plaintiff's claim against this defendant. The defendant corporation was not in existence when the order for these articles was given, nor for nearly three months afterwards, and it was not authorized to do business under Rev. Laws, c. 110, §§ 43, 44, until the expiration of

nearly a month after its certificate of incorporation was issued, and more than two weeks after the last of the articles had been delivered to Welch.

Even if Welch had assumed to act for a corporation which was then expected to be formed, which does not appear in the statement of facts, and if the corporation had attempted to ratify his act as its agent, it could not have made the original contract binding upon it without introducing into the transaction such elements as would be a sufficient foundation for a new contract. *Penn Match Co. v. Hapgood*, 141 Mass. 145, 7 N. E. 22; *Abbott v. Hapgood*, 150 Mass. 248-252, 22 N. E. 907, 5 L. R. A. 586, 15 Am. St. Rep. 193; *Holyoke Envelope Co. v. United States Envelope Co.*, 182 Mass. 171, 65 N. E. 54.

In this case nothing is stated which has any tendency to connect the defendant with the sale of these goods by the plaintiff. We have only the fact "that after incorporation the property came into the possession of the defendant by a transfer from Welch," which, so far as it shows anything, indicates a sale by Welch to the defendant.

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### III. Liability of Promoters to Corporation and Stockholders \*

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#### DAVIS v. LAS OVAS CO.

(Supreme Court of the United States, 1913. 227 U. S. 80, 33 Sup. Ct. 197, 57 L. Ed. 426.)

MR. JUSTICE LURTON. This is a bill by the appellee to recover from appellants secret profits made by them as promoters of the Las Ovas Company in the purchase of a part of a tract of land known as Las Ovas in the Republic of Cuba, and also for the cancellation of certain shares of stock issued to them as promoters.

The facts essential to judgment are not in serious dispute. They are found clearly and fully stated in the opinion by Justice Gould of the Supreme Court of the District of Columbia, and again in the opinion of the Court of Appeals of the District by Mr. Justice Robb.

From the facts found by both courts it appears:

(a) That the appellants and certain other persons, not parties to this suit, signed an agreement on March 19, 1904, by which they agreed to purchase for a corporation which they were to organize a specified part of a tract of land in Cuba called the Las Ovas plantation, for the price of \$34,000, to which it was later agreed to add another small parcel at an additional price of \$1,000.

(b) It was further agreed that they should organize a corporation, of which they should be the incorporators, with a capital stock of

\* For discussion of principles, see Clark on Corp. (3d Ed.) § 48.



\$150,000, and that 40 per cent of the shares should be issued to them for service as promoters and that the remaining stock should be subscribed for by them. For this subscribed stock they were to pay an amount sufficient to cover the purchase money of \$35,000 and to create an expense fund of \$5,000.

(c) It was agreed that the property should, when acquired, be placed in the hands of one of the group of promoters until the formation of the company, and then conveyed to it.

(d) The scheme was one originated and engineered by the appellants, who at the time of this agreement had already secretly secured an option for themselves for the purchase of this property at the price of \$20,000. To conceal the true consideration from their associates they caused the property to be conveyed by the vendor to one Escalante, a stranger selected by them. The deed to Escalante recited the true consideration. Later, in pursuance of the promoters' agreement, they caused Escalante to convey to the member of the syndicate selected to hold the title until organization, reciting a consideration of \$35,000.

The corporation was organized as planned. The promoters' shares were duly issued and the remaining shares taken by the promoters upon the agreed terms, its officers and directors being composed exclusively of the members of the syndicate. Thereupon the property was transferred to the company and paid for, through appellants, out of the proceeds of the subscribed stock.

The result of the transaction was that the corporation was required to pay to those who had assumed to act for and represent it, a secret profit of fifteen thousand dollars and also to compensate them for their services in buying the land and organizing the company by issuing to each of them fifteen thousand dollars in non-assessable shares of its stock.

The decree below required the appellants to account for the profits realized by them, in part traced to certain shares in their hands, and to surrender for cancellation the shares issued to them as promoters.

It is now said that the corporation was "a mere convenient receptacle for the property, erected for the convenience of the syndicate." That the property was bought by the syndicate for their own advantage and that the corporation included only the members of the syndicate. That the stock of the company was all taken by the syndicate, who, for property which was their own, agreed to pay enough to cover the purchase price and create a small expense fund.

Upon this contention it is urged that the corporation has no right to the relief sought, as the whole transaction was a mere form adopted by the parties for their own convenience as owners of the property and owners of the corporation. It is then said: "If we admit, for the purposes of this point, that appellants did deceive some of the syndicate, what has the company to do with it?" For this they cite *Old Dominion Copper Co. v. Lewisohn*, 210 U. S. 206, 28 Sup. Ct. 634, 52 L. Ed. 1025, where it was held that a subordinate fraud practiced by some of

the promoters of the corporation upon some of their associates was a matter wholly between them and the syndicate which gave rise to no corporate right of action in the absence of innocent incorporators or stockholders.

But that is not this case. Some of those, if not all, interested by appellants in the property and in its purchase for a proposed consideration were ignorant of the real price which they were to pay for it, and were not, therefore, in complicity with their scheme to make a secret profit. These innocent members of the syndicate became stock-subscribers and directors of the company, as did appellants. The buyers and sellers were not the same. Those of the syndicate assuming to act for the corporation in acquiring the property were under obligation to disclose the truth and deal openly. In the absence of such disclosure the corporate assent was obtained on false grounds. The wrong was done when those members of the syndicate not in complicity with appellants subscribed to the stock of the company and aided their guilty associate managers in the corporate action necessary to the corporate acquisition of the property at the exaggerated price placed upon it by those who were to realize a secret profit. Thus, the original fraud practiced upon some of those associated with them in the promoters' arrangement became operative against the corporation itself. The standing of the corporation results from the fact that there were innocent and deceived members of the corporation when the property was taken over by it.

Neither is the corporate right of action defeated by the fact that the recovery will inure to the guilty as well as to the innocent, nor is the fact that all of the parties who may have shared in the secret profits are not sued fatal to the case. The corporation may well sue either one or all of those who received secret profits. There is not want of necessary parties because all are not here sued.

The distinction between a case in which all of the owners of the property and all of the members of the buying corporation are the same persons, and participate in the profit realized, and the case here presented is fully recognized in *Old Dominion Copper Co. v. Lewisohn*, supra, as well as in *Phosphate Company v. Erlanger*, 5 Ch. Div. 73, and in the well considered opinion of Judge Severens in *Yeiser v. United States Paper Co.*, 107 Fed. 340, 46 C. C. A. 567, 52 L. R. A. 724.

There was no error in cancelling the shares issued to the plaintiffs in error for promotion of the corporation. They and the other members of the syndicate received these shares upon the assumption that they had in good faith served the corporation in the procurement of the property. Obviously appellants were serving themselves to the detriment of the corporation and innocent subscribers to its stock. In such a situation the corporation may recover the shares.

The decree will be affirmed.

## MOORE v. WARRIOR COAL &amp; LAND CO.

(Supreme Court of Alabama, 1912. 178 Ala. 234, 59 South. 219, Ann. Cas. 1915B, 173.)

Appeal from Chancery Court, Jefferson County; A. H. Benners, Chancellor.

Action by the Warrior Coal & Land Company against Walter Moore and others. From a decree overruling demurrers to a bill, defendants appeal. Affirmed.

DOWDELL, C. J. The Warrior Coal & Land Company, a corporation organized under the laws of this state, files this bill against its promoter, Walter Moore, and his alleged guilty confederates, and the bill also makes all of the stockholders of the complainant parties respondent. The bill charges infidelity and fraud in the organization of the corporation by the promoter, both prior and subsequent to the issuance of its charter, and seeks to have an accounting by the promoter, and prays also the cancellation of the certificates of stock in said corporation illegally issued to the promoter. The bill is lengthy, setting out in detail the facts relating to the organization of the complainant corporation, the purposes of its creation, and the wrongs and frauds perpetrated by its promoter, Walter Moore, and his aiders.

The case as made by the bill is fairly summarized in brief of counsel for appellee as follows: Walter Moore, as a promoter, induced J. B. Cavanaugh and others to go into the scheme of forming a corporation, the Warrior Coal & Land Company, complainant in this bill, upon the basis of all, including himself and his associates, paying for stock at par, the money to be used for buying coal lands through him, the said Moore; such lands to be turned in to the company at cost and paid for with money derived from such issuance of stock. Moore was to organize the company, handle the money, do the buying, and, in fact, do everything. He was intrusted with, and exercised, such management and control from the time of the formation of the project, before the company was actually formed, until several years after it was organized. The bill specifically and in detail sets out a series of concealments, frauds, and misrepresentations practiced by said Moore, running down to a short while before the filing of the bill, practiced by him to such effect that the innocent stockholders holding original issues had contributed for such stock at par \$116,000, of which only about \$90,000 has been so expended by him; that he and his guilty associates owed the company on that account alone \$26,000, besides \$29,000 for stock issued without consideration to Moore and sold to innocent holders; and that there was left outstanding, in the names of Moore and his associates in the fraud, \$73,500 at par of stock for which nothing was paid. C. S. Simmons, one of the respondents, was used by the said Moore as the company's trustee for conduit of title from the vendors to the company. Only money so paid into the company was used in the purchase of the lands. Simmons, as trustee,



deeded some lands to the company, of which he furnished no muniments or evidence of title in himself. The bill asks for such deeds and muniments of title. Simmons also furnished deeds to himself as such trustee to lands he has not conveyed to the company; the titles to which are by the bill sought to be divested out of him and vested in the company. Moore for a long time evaded making any statement of receipts and expenditures; and, when pressed, made a general one which is charged to be false, and he still fails and refuses to make any other statement, claiming that no books were kept. The bill asks for an accounting from him. On July 10, 1906, when Cavanaugh and his associates consented to go into the enterprise, he paid Moore, in order to enable him to proceed to negotiate for and purchase the lands for the company then to be organized, the sum of \$27,000, and on July 23, 1906, \$20,000 additional; Moore falsely representing that he (Moore) had advanced \$30,000 and that more money was needed for instant purchase to keep others, then attempting to buy, from buying.

Moore and his confederates organized the company on August 17, 1906, and soon thereafter said Cavanaugh, for his associates, resumed sending, and continued to send, in money until he had sent Moore, for the company, \$107,500 for which stock at par, as agreed, was issued. Moore represented during the negotiation, and before the company was formed, that he and his associates had arranged to pay in for stock at par, under such understanding with Cavanaugh, approximately \$80,000, which was false. Moore, as president of the company, and Simmons, as secretary, issued shares to dummies, in whose names original certificates of shares were made out, later canceling the same and re-issuing them to Moore. In the form of the declaration for organization Moore, Steve Smith, and C. S. Simmons, trustee, represented that Moore had subscribed in money, for 200 shares, \$20,000; Steve Smith, for 50 shares, \$5,000; C. S. Simmons, individually for 50 shares, \$5,000; and C. S. Simmons, trustee, for 2,200 shares, payable in money with a contract to convey lands (not described), all of which statements were false. Moore had paid in nothing for himself, but had then already been furnished by Cavanaugh, for himself and associates, \$47,500. Steve Smith had paid in nothing, and Simmons had paid in nothing. The lands had not been acquired from the original owners, or, if any, only a small part, and payment had been made out of the \$47,500 furnished by Cavanaugh and his associates. No shares were ever issued to Simmons, trustee, and his subscription as trustee for the 2,200 shares, if he ever so subscribed, was merely for the purpose of perfecting the organization.

The general plan of the enterprise, as shown by the bill, was (1) that all participants were to pay money for stock at par, Moore and Cavanaugh, through themselves and associates, to contribute approximately the same amounts in the aggregate, for the purpose of (2) buying coal in place in lands at cost, which could, in small tracts, be purchased cheaply, but, when bodied up into one corporate ownership, would be

worth very much more, thus making the value of the shares higher than par, to the equal advantage and benefit of all, according to the respective sums of money paid for stock. The general purpose and end of the bill is to preserve in its integrity the object of the enterprise.

Moore and Simmons each interposed the general demurrer which tests the equity of the bill as to him. These demurrers were overruled by the chancellor, and the present appeal is prosecuted from the decree overruling the demurrers. And the only question now presented for our consideration is whether or not the bill contains equity.

Moore was a promoter of the complainant corporation, and his relation as such to the corporation, as well as to those whom he might induce to put their money into the project and become stockholders, was of a fiduciary character, calling for the utmost good faith and fair dealing. In *Thompson on Corporations* (volume 1, § 457), the law is thus stated: "Promoters of a corporation occupy a fiduciary relation to it and have no right to derive any advantage over other stockholders without a full and fair disclosure of the transaction, and any secret profits which they may acquire through promoting the corporation must be refunded, and may be recovered in equity by the corporation or its legal representative, and in many cases at law. \* \* \* The principle upon which courts of equity proceed in these cases is a very familiar one. The promoter of a company, like its directors, is deemed to sustain towards the members of the company the relation of a trustee towards his cestui que trust. This being so, he will not be permitted to speculate out of that relation, or to derive secret advantages from it. He is bound to disclose to them fully all material facts touching his relation to them," etc. To the same effect the law is stated in 10 Cyc. pp. 274-280.

In *Dickerman v. Northern Trust Co.*, 176 U. S. 203, 204, 20 Sup. Ct. 311, 319 (44 L. Ed. 423), it is said: "A promoter is one who 'brings together the persons who become interested in the enterprise, aids in procuring subscriptions, and sets in motion the machinery which leads to the formation of the corporation itself' [citing *Cook on Stocks and Stockholders*, § 651]. \* \* \* He is treated as standing in a confidential relation to the proposed company, and is bound to the exercise of the utmost good faith [citing *Lloyd, Corporate Liability*, 18, and other authorities]. The promoter is the agent of the corporation and subject to the disabilities of the ordinary agent. His acts are scrutinized carefully, and he is precluded from taking a secret advantage of the other stockholders. \* \* \* If the promoters are guilty of any misrepresentation of facts or suppression of the truth in relation to the character and value of the property of their personal interest in the proposed sale, the company will be entitled to set aside the transaction or recover compensation for any loss it has suffered." For other citation of authorities to the same effect, we refer to brief of counsel for appellee.

From the above-cited authorities and others cited in brief of counsel for appellee, the following principles of law may be deduced in respect to the relations promoters occupy to the corporation and to those whom they induce to enter into the enterprise and become stockholders, as well as towards each other, and the duties they owe to the company and the stockholders. Their relation is of a fiduciary character, calling for the utmost good faith, and they will not be permitted to take secret profits in the form of stock or otherwise. Where their interests are antagonistic, they cannot be silent; they must disclose. A failure to inform is a fraud. Their position is, in a sense, that of a trustee, and they may be held to an accounting for any breach of the trust. The corporation is a proper party in such cases to file the bill and to obtain relief; it is not necessary to rescind or set aside the transaction. The bill may, however, be maintained by the injured shareholders, where redress cannot be had through the corporation, because of being under control of the perpetrators of the wrong.

Applying the principles of law as stated to the facts charged in the bill, which are to be taken as true on demurrer, we think there can be no doubt as to the equity of the bill. The project proposed by the promoters was to organize a corporation and issue shares of stock, for money paid in, at par value, and with this money to purchase coal in place in lands in small tracts and body the same up into one tract, and by so doing increase the value of the holding, and, as a result, give a greater value to the shares of stock issued for the money so paid in. Such was the inducement held out by the promoters, and those paying in their money have an equity in preserving and carrying out the project, and to this end to call to an accounting the unfaithful promoters who, by their fraud, have thwarted the project.

It is no answer to this theory of the bill to say that the lands conveyed to the corporation and now held by it were sold to it at a fair price and are equal in value to the par value of the total capital stock of the corporation. Those who were induced to pay in money for stock upon the representations made by the promoters were entitled to have the lands at cost and to be purchased under the proposed scheme.

It is contended by counsel for appellant that the written agreement between the promoters, Moore and Cavanaugh, attached as an exhibit to the bill, for the formation of the company shows on its face that subscriptions to the capital stock of the corporation might be made in lands. We do not so construe the agreement, and, if susceptible of such construction, on the facts stated in the bill it was not so construed by Moore and Cavanaugh, but, on the contrary, they treated it as requiring the stock to be subscribed and paid for in money.

The bill, moreover, seeks the cancellation of shares of stock charged to have been fraudulently issued, and also to have an accounting for money charged to have been fraudulently used or misappropriated by Moore and his confederates. Taking the statements of the bill as true,



and which we must do on the general demurrer for want of equity, interposed by the respondents Moore and Simmons, we have no doubt that the bill contains equity, and hold consequently that there was no error in overruling the demurrer. The decree will be affirmed.

Affirmed. All the Justices concur.

## POWERS AND LIABILITIES OF CORPORATION

I. Construction of Charters <sup>1</sup>

## DOWNING v. MT. WASHINGTON ROAD CO.

(Supreme Court of New Hampshire, 1860. 40 N. H. 230.)

Assumpsit, brought by Lewis Downing & Sons, to recover the price of eight omnibuses, and a model for the same, one light wagon, and one baggage wagon, made for the defendants, under a contract entered into by D. O. Macomber, president of the defendant corporation in their behalf.

The light wagon was made and sent to one Cavis, the agent for building the road, and was used by him in making it. The omnibuses and baggage wagon were intended to be used in conveying passengers up and down the mountain, after the road was completed. The omnibuses were constructed in a peculiar way, and are not fit for use on ordinary roads.

By their act of incorporation, passed July 1, 1853, the corporation was empowered to lay out, make, and keep in repair, a road from such point in the vicinity of Mt. Washington as they may deem most favorable, to the top of said mountain, etc., and thence to some point on the northwesterly side of said mountain, etc., to take tolls of passengers and for carriages, to build and own toll-houses, and to take land for their road.

The corporation was duly organized, and at a meeting of the directors on the 31st of August, 1853, before said contract was made, it was "voted that the president be the legal agent and commissioner of the company," and his compensation as such was fixed.

"The president" was "directed to proceed with the letting of the work for the construction of the road, \* \* \* the obtaining the right of way," and "what other action he shall deem proper for the interests of the company," etc.

A committee was appointed "to settle in relation to the right of way, etc., and in relation to land on which to build stables and other buildings, for the use of the road, and also for building all such stables and houses as may be necessary for the operations of the company."

It appeared that by an additional act, passed July 12, 1856, the corporation were authorized "to erect and maintain, lease and dispose of any building or buildings, which may be found convenient for the accommodation of their business, and of the horses and carriages and travelers passing over said road."

<sup>1</sup> For discussion of principles, see Clark on Corp. (3d Ed.) § 53.

The defendants denied the authority of Macomber to make such a contract in behalf of the corporation, and the power of the corporation under its charter either to authorize or to enter into such a contract.

BELL, C. J. Corporations are creatures of the legislature, having no other powers than such as are given to them by their charters, or such as are incidental, or necessary to carry into effect the purposes for which they were established. *Trustees v. Peaslee*, 15 N. H. 330; *Perrine v. Chesapeake Canal Co.*, 9 How. 172, 13 L. Ed. 92. "In giving a construction to the powers of a corporation, the language of the charter should in general neither be construed strictly nor liberally, but according to the fair and natural import of it, with reference to the purposes and objects of the corporation. *Enfield Bridge v. Hartford R. R.*, 17 Conn. 454, 44 Am. Dec. 556; *Straus v. Eagle Co.*, 5 Ohio St. 59.

If the powers conferred are against common right, and trench in any way upon the privileges of other citizens, they are, in cases of doubt, to be construed strictly, but not so as to impair or defeat the objects of the incorporation.

In the present case the power to take the lands of others, and to take tolls of travellers, must be strictly construed, if doubts should arise on those points; but it is not seen that the other grants to the defendant corporation should not receive a fair natural construction.

The charter of the Mt. Washington Road empowers them to lay out, make and keep in repair, a road from Peabody River Valley to the top of Mt. Washington, and thence to some point on the northwest side of the mountain. It grants tolls on passengers and carriages, and authorizes them to take lands of others for their road, and to build and own toll-houses, and erect gates, and appoint toll-gatherers to collect their tolls. The remaining provisions contain the ordinary powers of corporations relating to directors, stock, dividends, meetings, etc. Laws 1853, c. 1486.

This chapter confers the usual powers heretofore granted to turn-pike corporations, and no others. The most natural and satisfactory mode of ascertaining what are the powers incidentally granted to such companies, is to inquire what powers have been usually exercised under them, without question by the public or by the corporators. It may be safely assumed that the powers which have not heretofore been found necessary, and have not been claimed or exercised under such charters, are not to be considered generally as incidentally granted. Such charters have in former years been very common in this and other states, and they have not, so far as we are aware, been understood as authorizing the corporations to erect hotels, or to establish stage or transportation lines, to purchase horses or carriages, or to employ drivers in transporting passengers or freight over their roads; and no such powers have anywhere been claimed or exercised



under them. We are, therefore, of opinion that the power to establish stage and transportation lines to and from the mountain, to purchase carriages and horses for the purpose of carrying on such a business, was not incidentally granted to the defendant corporation by their charter. *State v. Commissioners of Mansfield*, 23 N. J. Law, 510, 57 Am. Dec. 409.

But it is contended that the power to make this contract is conferred by the act in amendment of the charter, passed July 12, 1856. By this act the corporation may "erect and maintain, lease and dispose of any building or buildings which may be found convenient for the accommodation of their business and of the horses and carriages and travellers passing over their said road." By their business, which the buildings to be erected were designed to accommodate, it is said the legislature must have intended some permanent and continuing business beyond that of merely building and maintaining a road; and that it could be no other than that of erecting a hotel on the mountain, and establishing lines of carriages, for the purpose of carrying visitors up and down the mountain.

But the foundation of this implication is very slight. The express grant is of an authority to erect, etc., buildings, not of all kinds, but such as may be found convenient for the accommodation of their business, and of travellers, etc. The business here referred to must be understood to be such as they are by their charter authorized to engage in. If nothing had been said of horses and travellers, there could hardly be any foundation for the idea that a hotel could have been contemplated by the legislature. Buildings suitable for the accommodation of their toll-gatherers and workmen employed on their road, would probably be thought everything the legislature intended to authorize by this additional act. Connected as this authority now is with travellers, horses, and carriages, there is scarce a pretence for argument that this additional act goes any further than the original act, to authorize a stage and transportation company. It is not unlikely that some of the projectors of this enterprise intended to secure much more extensive rights than those of a turnpike and hotel company, but it seems certain they have not exhibited this feature of their case to the legislature so distinctly as to secure their sanction, and the charter and its amendment as yet justifies them in no such claim.

The power of buying and selling real and personal property for the legitimate purposes of the corporation, and the power of contracting generally for the same purposes, within the limits prescribed by the charter, being granted, we understand the principle to be, that their purchases, sales, and contracts generally, will be presumed to be made within the legitimate scope and purpose of the corporation, until the contrary appears, and that the burden of showing that any contract of a corporation is beyond its legitimate powers, rests on the party who objects to it. *Indiana v. Woram*, 6 Hill (N. Y.) 37, 40 Am. Dec. 378; *Ex parte Peru Iron Co.*, 7 Cow. (N. Y.) 540; *Farmers'*

Loan & Trust Co. v. Clowes, 3 N. Y. 470; Farmers' Loan & Trust Co. v. Curtis, 7 N. Y. 466; Beers v. Phoenix Glass Co., 14 Barb. (N. Y.) 358.

If a corporation attempt to enforce a contract made with them in a case beyond the legitimate limits of their corporate power, that fact, being shown, will ordinarily constitute a perfect defence. *Green v. Seymour*, 2 Sandf. Ch. (N. Y.) 285; *Bangor Boom v. Whiting*, 29 Me. 123; *Life & Fire Ins. Co. v. Mechanic Fire Ins. Co.*, 7 Wend. (N. Y.) 31; *New York, etc., Ins. Co. v. Ely*, 5 Conn. 560, 13 Am. Dec. 100.

And if a suit is brought upon a contract alleged to be made by the corporation, but which is shown to be beyond its corporate power to enter into, the contract will be regarded as void, and the corporation may avail themselves of that defence. *Beach v. Fulton Bank*, 3 Wend. (N. Y.) 573; *Albert v. Savings Bank*, 1 Md. Ch. 407; *Abbott v. Baltimore, etc., Co.*, 1 Md. Ch. 542; *Straus v. Eagle Ins. Co.*, 5 Ohio St. 59; *Bacon v. Mississippi Ins. Co.*, 31 Miss. 116; *Bank of Genesee v. Patchin Bank*, 13 N. Y. 315; *Gage v. Newmarket*, 18 Q. B. 457.

The contract set up in this case, was made not by the corporation itself, by a vote, nor by an agent expressly authorized to sign a contract already drawn, but it was made by the president of the corporation, acting under an appointment as their general agent; and it is argued that he was fully authorized by votes of the corporation to bind them by such a contract as the present; but it is not necessary to consider this question, as we think it settled that the powers of the agents of corporations to enter into contracts in their behalf are limited, by the nature of things, to such contracts as the corporations are by their charters authorized to make. This principle is distinctly recognized in *McCullough v. Moss*, 5 Denio (N. Y.) 567; overruling the case of *Moss v. Rossie Lead Co.*, 5 Hill (N. Y.) 137, and in *Central Bank v. Empire Stone-Dressing Co.*, 26 Barb. (N. Y.) 23; *Bank of Genesee v. Patchin Bank*, 13 N. Y. 315.

The same want of power to give authority to an agent to contract, and thereby bind the corporation in matters beyond the scope of their corporate objects, must be equally conclusive against any attempt to ratify such contract. What they cannot do directly they cannot do indirectly. They cannot bind themselves by the ratification of a contract which they had no authority to make. 5 Denio (N. Y.) 567, above cited. The power of the agent must be restricted to the business which the company was authorized to do. Within the scope of the business which they had power to transact, he, as its agent, may be authorized to act for it, but beyond that he could not be authorized, for its powers extend no further.

This view seems to us entirely conclusive against the claim made for the omnibuses and model, and probably for the baggage wagon.

As to the light wagon, that may stand on a different ground. Such

a wagon might be useful and necessary for the use of the agent of the company, in conducting the undoubted business of the corporation,—the building and maintaining the road.

We are unable to assent to the position taken in the argument, that a ratification of part is a ratification of the whole contract. While the corporation may be restricted from ratifying a contract beyond the scope of the objects of the corporation, there could be no such objection as to any matter clearly within their power. The other contracting party might have a right to reject such ratification, claiming that the contract is entire, and if not ratified as such, it should not be made good for a part only. But if they claim the benefit of the partial ratification, the corporation can hardly object.

## II. Power to Take and Hold Real and Personal Property<sup>2</sup>

### FAYETTE LAND CO. v. LOUISVILLE & N. R. CO.

(Supreme Court of Appeals of Virginia, 1896. 93 Va. 274, 24 S. E. 1016.)

Appeal from Circuit Court.

Bill in equity by L. & N. R. Co. against Fayette Land Co. et al., to enforce payment for land sold by plaintiffs to defendants. In 1888, Flanary and wife conveyed to H. M. Smith, agent, a tract of 330 acres in Wise County, Va. In this transaction Smith was acting as agent for the L. & N. R. Co. In 1890 the L. & N. R. Co. conveyed to the Fayette Land Co. this tract, reserving a right of way and a depot site. One third of the purchase money was paid down. The remainder was payable in 1891 and 1892; and the vendor retained a lien on the land conveyed. H. M. Smith united in the deed to the Fayette Land Co. The bill avers that the balance of the purchase money is still unpaid, and prays that the defendant company may be required to pay it. Such proceedings were had that the Circuit Court entered a decree in favor of plaintiff for the balance claimed.

KETH, P.<sup>3</sup> \* \* \* These preliminary matters having been disposed of, we come now to the seventh assignment of error, which is that the court erred in giving a decree against the appellants on the merits.

The Louisville & Nashville R. R. Co. is a Kentucky corporation, authorized by an act of Assembly of this State, approved March 30, 1887 (Acts Extra Session, 1887, p. 19), to construct and operate a line of railroad in Virginia. By that Act it is made subject to all the

<sup>2</sup> For discussion of principles, see Clark on Corp. (3d Ed.) § 54.

<sup>3</sup> The statement of facts is abridged and part of the opinion is omitted.



limitations and restrictions imposed by the laws of Virginia upon railroad companies, and it is contended by appellant that section 1073 of the Code of 1887, which is as follows: "The land acquired by any company incorporated for a work of internal improvement along its line generally, shall not exceed one hundred feet in width, except in deep cuts, and fillings, and then only so much more shall be acquired as may be reasonably necessary therefor; the lands which it may acquire for buildings or for an abutment along its line generally, shall not exceed three acres in any one parcel; and the land which it may acquire for buildings, or other purposes of the company at the principal termini of its work, or any place or places within five miles of such termini, shall not exceed fifteen acres in any one parcel; but in the case of a railroad company, land not exceeding forty acres in any one parcel may be acquired for its main depots, machine shops, and other necessary purposes connected with the business of said company"—renders the appellee incapable of acquiring or taking title to the real estate set out and described in its bill, and that therefore no title passed from it to the appellant, but that it is or was absolutely void or conveyed at most a defeasible title, the land being subject even in the hands of an alienee from a railroad company to be escheated to the Commonwealth. It may be conceded that if this were a bill for specific performance of a contract that the relief would be denied. See *Case v. Kelly*, 133 U. S. 21, 10 Sup. Ct. 216, 33 L. Ed. 513. But such is not the case. The agreement of the parties has been fully executed.

Section 1068 declares that: "Every corporation, in respect to which it is not otherwise provided, shall have perpetual succession and a common seal; \* \* \* that it may contract and be contracted with, purchase, hold, and grant estates, real and personal, and make ordinances, by-laws and regulations \* \* \* for the management of its estates, and the due and orderly conducting of its affairs." This section is but declaratory of the common law.

Section 1070 declares: "No incorporated company shall hold any more real estate than is proper for the purposes for which it is incorporated," &c. This again is but a recognition of the common law principle.

Section 1072 provides the mode in which a company incorporated for internal improvement may enter upon land for the purpose of examining and surveying it.

Section 1073 has already been quoted in full.

That the conveyance of this land to the Louisville & Nashville R. R. Co. was not void is abundantly established by authority.

In the case of *Banks v. Poitiaux*, 3 Rand. 136, 15 Am. Dec. 706, it appears that the banks were by their charters authorized to hold such real estate "as was requisite for their immediate accommodation in relation to the convenient transacting of their business." Upon the

lands purchased by the banks in that case they proceeded to erect buildings for the transaction of their business, and on either side of the buildings so erected there remained a vacant space, which they sold to the appellee; he failing to pay as agreed, the bank filed a bill for specific performance, and the chancellor decreed that the banks had exceeded their powers in purchasing and selling the property in question, it not being necessary in relation to the transaction of their business. Upon appeal it was held that while the power to acquire may be limited, restrained or prohibited, either by the charter creating the corporation or by a general law, such was not the effect of the charters in question, because the acts creating the charters are, with respect to the quantity of real estate which they were capable of holding, only directory.

"They impose no penalty in terms. They do not declare the purchase by, or conveyance to, the banks to be void, nor vest the title in the Commonwealth, or any other than the banks, in consequence of such purchase and conveyance. The legal title passed to the banks by the conveyance to them, and their conveyance would effectually transfer that title to any other. If, in making the purchase of the land in question, the banks violated their charters, the corporation might, for that cause, be dissolved by a proceeding at the suit of the Commonwealth; and even in that case, it seems to be the better opinion, the property, if not previously conveyed to some other, would revert, upon the dissolution of the corporation, to the grantor, and not to the Commonwealth. But, any conveyance made by the corporation, before its dissolution, would be effectual to pass its title. The banks have, therefore, a title which they can convey to the appellee, and which would, in his hands, be indefeasible. It would seem extremely inconvenient, if every contractor with one of these banks could, for the purpose of avoiding his contract, institute the enquiry whether the bank had violated its charter."

In *Silver Lake Bank v. North*, 4 Johns. R. Ch. (N. Y.) 370, the same principle is recognized.

In *Bank v. Matthews*, 98 U. S. 621, 25 L. Ed. 188, it is said: "Where a corporation is incompetent by its charter to take title to real estate, a conveyance to it is not void."

In *Mallett v. Simpson*, 94 N. C. 37, 55 Am. Rep. 595, it was held that although a corporation is forbidden by its charter to hold real estate, yet a deed of land to it is valid, "and even when the right to acquire real property is limited by the charter, and the corporation transcends its power in that respect, a conveyance to it is not void, but only the sovereign can object. It is valid until assailed in a direct proceeding instituted by the sovereign for that purpose."

In *Nat. Bank v. Whitney*, 103 U. S. 99, 26 L. Ed. 443, the bank had taken security upon real estate for a loan which it was prohibited to do by the National Banking Law. Mr. Justice Field, delivering the

opinion, said that "the statute did not declare such security void, but was silent on the subject; that had Congress so intended it would have been easy to say so, and it can hardly be presumed that this would not have been done instead of leaving the question to be settled by the uncertain result of litigation and judicial decision." And, after citing numerous cases where a disregard of statutory prohibitions has not been held to vitiate the contracts of parties, but only to authorize actions by the Government against them, the court held that the prohibitory clauses of the banking law did not vitiate real estate securities taken for loans, and that a disregard of them only laid the association open to proceedings by the Government. \* \* \* "That has always been the punishment prescribed for the wanton violation of a charter, and it may be made to follow whenever the proper public authority shall see fit to enforce its application."

In *Fritts et al. v. Palmer*, 132 U. S. 282, 10 Sup. Ct. 93, 33 L. Ed. 317, it is said by Mr. Justice Harlan, "that where a corporation is incompetent by its charter to take a title to real estate, a conveyance to it is not void, but only voidable, and the sovereign alone can object. It is valid until assailed in a direct proceeding instituted for that purpose."

The text writers are to the same effect. In 1 Beach on Corp. sec. 378, it is said: "No party except the State can object that a corporation is holding real estate in excess of its rights. Accordingly, under an Act which forbids a foreign corporation to 'acquire and hold' real estate, a deed of conveyance of land to such corporation is not void. It passes the title, and the corporation may hold the land subject to the Commonwealth's right to escheat. The Commonwealth alone can object to the legal capacity of a corporation to hold real estate. There must be a direct proceeding by the State for the purpose of vacating the deed."

In *Thompson on Corporations*, sec. 5795, it is said: "Although a corporation may be disabled or forbidden from holding land at all, or from holding land for particular purposes, or from holding land beyond a prescribed limit, yet if it does hold land in the face of such disabilities or prohibitions, its title will be good except as against the State alone, and that it will be deemed to have a good title until its title is invalidated in a direct proceeding instituted by the State for that purpose." And in section 5797 it is said: "Although the State might, in a direct proceeding for that purpose, have overthrown the title of the corporation and escheated the property to its own use, yet, not having done so, the corporation may in the meantime convey an indefeasible title to another, of whatever estate in the lands had been conveyed to or acquired by it."

The doctrine that the State alone can interfere seems to rest upon the principle suggested in *Banks v. Poitiaux*, *supra*, that it would be extremely inconvenient if every contractor with corporations might, for



the purpose of avoiding their contracts, be permitted to institute enquiry as to violations of the charter. It is a question which concerns public interests, and the State alone is competent to protect and defend them. *Runyan v. Lessee of Coster*, 14 Pet. (U. S.) 122, 10 L. Ed. 382; *Wroten's Assignee v. Armat et al.*, 31 Grat. 251.

Enough has been said to show that the conveyance to the Louisville & Nashville Railroad Company was not void, but that it served to vest the title in the appellant.

Is the deed voidable? As we have seen in discussing this first branch of this assignment of error, no one can be heard to question the right of a corporation to acquire and hold real estate, except the State by which the corporation was created, or that State within whose limits and by whose permission or authority, express or implied, it does business, and it must do so by a direct proceeding instituted for that purpose.

There is much plausibility in the suggestion of the appellee that section 1073 was designed to prohibit the acquisition of real estate by means of the exercise of the right of eminent domain, or by condemnation, as it is called, except to the extent and within the limits and in the mode appointed by that section.

By section 1068 corporations are authorized to purchase and hold real estate without any limitation whatsoever; by section 1070 they are prohibited to hold more real estate than is proper for the purposes for which they are incorporated. In order to give full effect to these sections as well as to section 1070, there is much room to contend that the first regulates the acquisition of real estate by contract, and that the last applies to proceedings by corporations for the condemnation of real estate.

But, granting that section 1073 applies to the acquisition by corporations of real estate without respect to the mode of acquisition, none of the sections referred to declare that the title shall be void. As was said in *Banks v. Poitiaux*, the statute law is only directory in this respect. It imposes no penalty in terms. It does not declare the purchase by or the conveyance to the banks to be void, nor vest the title in the Commonwealth in consequence of such purchase and conveyance. The only penalty incurred is that which waits upon every violation of its charter by an incorporated institution. The impending danger of a judgment of ouster and dissolution is, we think, the only check contemplated by the law. That has always been the punishment prescribed for the wanton violation of a charter, and it may be made to follow whenever the proper public authority may see fit to enforce its application. See *National Bank v. Whitney*, supra.

The statute of mortmain has never been adopted into the jurisprudence of this State. *Lomax's Dig.* (2d Ed.) p. 815; *Rivanna Navigation Co. v. Dawson*, 3 Grat. 21, 46 Am. Dec. 183; *Marshall v. Conrad*, 5 Call, 364. It is safe to say, therefore, that there is no

proceeding authorized by the common law of Virginia under which lands acquired by a corporation in violation of its charter can be forfeited to the State.

Is there any statutory authority by which it can be done? Chapter 105 of the Code is upon the subject of "Escheats and Property Derelict." It provides for the appointment of an escheator in every county; and section 2374 directs each commissioner of the revenue annually to furnish the escheator of his county or corporation with "a list of all lands within his district of which any person shall have died seized of an estate of inheritance intestate, and without any known heir, or to which no person is known by him to be entitled."

We have seen that by the deed from Flanary and wife the title passed to and vested in Smith as the agent of the Louisville & Nashville R. R. Co., and by a subsequent deed it was conveyed to the Louisville & Nashville R. R. Co. directly. The land in controversy, therefore, does not come within the terms of the section just quoted, for the commissioner of the revenue could not in the face of the conveyances of record rightfully say that there is no person known by him to be entitled to it.

It appears further that this property has been conveyed by deed from the appellee to the appellant, and that no proceedings have been taken by the State to revoke the privileges given the appellee by the Act of Assembly before referred to. Acts of Special Session 1887, p. 19. The deed of the Louisville & Nashville R. R. Co. was, therefore, effectual to pass its title to the land in controversy and vest it in the Fayette Land Company. See *Banks v. Poitiaux*, 3 Rand. at page 142, 15 Am. Dec. 706, and 5 Thomp. Com. on the Law of Corp. sec. 5797, and cases there cited.

We are of opinion, therefore, that the seventh assignment of error is not well taken, and, upon the whole case, the decree complained of must be affirmed.

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### III. Power to Borrow Money and Make Negotiable Instruments <sup>4</sup>

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#### ALTON MFG. CO. v. GARRETT BIBLICAL INSTITUTE.

(Supreme Court of Illinois, 1909. 243 Ill. 298, 90 N. E. 704.)

Appeal from Appellate Court, First District, on Appeal from Municipal Court of Chicago; Edward A. Dicker, Judge.

Action by the Alton Manufacturing Company against the Garrett Biblical Institute on notes. From a judgment of the Appellate Court

<sup>4</sup> For discussion of principles, see Clark on Corp. (3d Ed.) §§ 56, 57.

affirming a judgment for defendant entered on a directed verdict, plaintiff appeals. Reversed and remanded.

This is an appeal from a judgment of the Appellate Court affirming a judgment of the municipal court of Chicago against appellant for costs. Appellant, plaintiff below, sued the appellee in an action of assumpsit on three promissory notes. One of the notes was dated April 19, 1902, for \$5,000, payable four years after date. Another one was for \$2,000, dated November 15, 1902, payable four years after date, and another one was for \$13,000, dated December 9, 1903, payable three years after date. All three of said notes were payable to the order of Everett O. Fisk and were signed "Garrett Biblical Institute, by Robert D. Shepherd, treasurer." Each of said notes bore interest at the rate of five per cent. per annum, payable semiannually, and each is credited with the payment of all interest accruing down to and including the first installment of interest maturing in the year 1906. All three of the notes were indorsed by Fisk to appellant. The \$5,000 note was past due at the time of the indorsement and transfer to appellant. The other two were not then due. The declaration consisted of special counts on the three notes, and the common counts. Appellee filed three pleas to the declaration—the general issue, a plea denying the execution of the notes under oath, and a plea of want of consideration. Issues were joined on these pleas, and a trial had before a jury. Appellant, after introducing its preliminary proof, offered in evidence the notes sued upon. They were objected to by counsel for appellee, and a motion was then made by said counsel to direct a verdict in favor of appellee. The objection to the introduction of the notes was sustained, and the motion to direct a verdict allowed. In obedience to the directions of the court the jury thereupon returned a verdict finding the issues for appellee. A motion for a new trial was overruled and judgment rendered on the verdict. That judgment has been affirmed by the Appellate Court, and the case is brought to this court by further appeal.

FARMER, C. J. (after stating the facts as above). The first question necessary to be determined is whether the Garrett Biblical Institute, under its charter, was authorized to borrow money for its corporate purposes. The answer to this question must depend upon the provisions of the charter under which the corporation is operating, for the powers which any corporation is permitted to exercise are those, only, which its charter confers upon it, either by express grant or by implication, and the implied powers are recognized and given effect for the purpose of enabling such bodies to exercise the express powers granted. An incidental power is one that is directly and immediately appropriate to the execution of the specific power granted, and not one that has a slight or remote relation to it. *People ex rel. v. Chicago Gas Trust Co.*, 130 Ill. 268, 22 N. E. 798, 8 L. R. A. 497, 17 Am. St. Rep. 319; 10 Cyc. 1096. These implied or incidental powers which a corporation possesses in order to carry into effect the legitimate



purposes of its creation are not limited to such as are absolutely indispensable to this end, but include such powers, not expressly prohibited by the charter, as are reasonably necessary, by fair intendment, for the accomplishment of such purposes. 10 Cyc. 1097.

The Garrett Biblical Institute is a charitable corporation, created primarily for educational purposes. It is expressly empowered to establish and maintain within the bounds of Cook county a biblical institute under the patronage and control of the Methodist Episcopal Church. The conduct and control of the corporation are placed in a board of trustees. The original act or charter under which it was incorporated was passed in 1855 (Priv. Laws, 1855, p. 511), and fixed the number of trustees at five, but by an amendment to the act, passed in 1865, (Priv. Laws, 1865, p. 20), this number was increased to six. The trustees and their successors are elected by the Rock River Annual Conference of the Methodist Episcopal Church, and in case of a division of the said conference, then the annual conference within the bounds of which the said institute may be located shall elect such trustees. By section 1 of the act it is expressly declared that appellee "shall be capable, in law, of taking and holding, by gift, grant, devise, or otherwise, and of purchasing, holding, and conveying, both in law and equity, any estate or interest therein, real, personal, or mixed, and shall have power to execute and fulfill all such trusts as may be confided to said corporation, and to take, hold, use, manage, lease, and dispose of all such trust property as may in any manner come to said corporation charged with any trust or trusts in conformity therewith."

It will be observed that the power to borrow money and issue notes therefor is not expressly granted to appellee by the terms of its charter. But the almost universal rule of law is, that corporations possess the implied power to borrow money when necessary to carry out the purposes of their organization, and when such power is possessed and debts contracted thereunder a corporation may execute its notes or other customary evidences of indebtedness therefor. The authorities on this proposition are very numerous and an extensive collection of them will be found in Thompson on Corporations (vol. 3 [2d Ed.] pp. 87, 108), and in 10 Cyc. 1101; also, this rule is announced by Justice Scholfield in *Ward v. Johnson*, 95 Ill. 215. "This power to borrow is not limited either to particular kinds of corporations or to those organized for any particular purpose, but is possessed practically by all corporations whose business or objects may render it necessary or proper to resort to this method of raising money." 3 Thompson on Corporations (2d Ed.) § 2174. And it has been held that educational institutions and eleemosynary corporations may borrow money under this general power or authority. *Moss v. Harpeth Academy*, 7 Heisk. (Tenn.) 283; *Hayward v. Pilgrim Society*, 21 Pick. (Mass.) 270.

The charter of appellee does, however, grant to it the express power of purchasing, holding, and conveying, in law and equity, any estate

or interest therein, real, personal, or mixed, and the power to hold, use, and manage the same. Under this power it cannot be questioned that appellee may expend money for the purchase of real estate for the use of the institute, and to maintain and keep it in repair, and it is equally clear that if it did not possess the ready funds at a time when it might be necessary to the purposes of the corporation to make a purchase of real estate, or necessary to make expenditures for needed repairs and maintenance of property which it owned, under its charter it possessed the implied power to borrow money for such purposes and give its notes therefor. The trustees having power to borrow money for proper corporate purposes and execute notes therefor, might exercise this authority in a number of ways: (1) They might appoint one of their number as agent of the corporation for that purpose and expressly or impliedly clothe him with authority to borrow money and give notes; (2) where no actual authority has been conferred upon the agent of the corporation to borrow money and give notes, but where the agent has done so, and with full knowledge of all the facts the corporation has approved and ratified the acts of the agent, it will be liable to the same extent as if actual authority had been given to perform the act; (3) where no authority had been given or existed in the agent to borrow money, but where the corporation received the use and benefit of the money it will be liable; (4) by holding an agent out to the public as possessing authority to exercise the powers assumed by the agent and to do the acts performed by him, in which case the corporation would be bound to the extent of the agent's apparent authority.

Our first inquiry, then, relates to the correctness of the ruling of the trial court in holding that there was no evidence tending to show that Dr. Shepherd, treasurer and "business agent" or "business manager" of the corporation, had ever been given any authority by the trustees to borrow money and execute the notes of the corporation therefor. This necessitates an examination of the testimony to some extent.

The mere appointment of Dr. Shepherd as treasurer, or his appointment (if he was so appointed) as "business agent" or "business manager," would not have, of itself, invested him with any authority to borrow money and give the obligations of the corporation. If he was given such authority it must be traced to some other source than his mere appointment by the trustees to these positions. Dr. Shepherd was one of the trustees of appellee for some years prior to his election, April 20, 1897, to the office of treasurer of the corporation, and he continued thereafter as one of said trustees. The minutes of the proceedings of the board of trustees show that on May 6, 1897, Dr. Shepherd was directed "to make a careful examination of the Garrett building in Chicago with a view of making such alterations as will increase the income from the property and to report his recommendations to the board of trustees, with plans and estimates of the probable expense of the alterations and recommendations." We are unable to

find in the abstract any report of Dr. Shepherd made in pursuance of this authority and direction. The minutes of a meeting of the trustees held May 26, 1898, show that Dr. Shepherd presented a form of lease with Reid, Murdoch & Co., with memoranda and specifications; that the same were approved and "the proper officers of this board of trustees be authorized and directed to execute the same." At the same meeting a resolution was adopted "that R. D. Shepherd, treasurer, be authorized to arrange for a building loan for the purpose of constructing the building referred to in the foregoing lease, the amount not to exceed three hundred thousand (\$300,000) dollars, and that, pending negotiations for such a loan, he be authorized to make temporary loans as the necessity of the progress of the work may demand." The president and secretary were authorized to execute such building contracts for the construction of the building as they and the treasurer might approve. This building was to be erected upon land owned by appellee, and formerly occupied by a building known as the "Garrett building."

At a meeting of the trustees of the appellee May 25, 1899, Dr. Shepherd reported that the building was not yet complete and that some of the money due for its construction was being held until the work was approved. Dr. Shepherd also reported that appellee owned real estate with a 20-foot frontage on Randolph street for which he had been offered \$30,000; that he could buy 20 feet adjacent to it for \$26,000, and asked the board to determine whether it would sell its property or buy the adjacent property and improve the whole by erecting a building thereon. A motion was made and adopted by the board of trustees that the matter be left to a committee, consisting of William Deering and Dr. Shepherd, with full power to determine what should be done in the matter. As we understand the evidence it was determined to sell this property, and it was sold for \$30,000. In 1901, on the recommendation of Dr. Shepherd, the board of trustees of appellee ordered the construction of two other buildings upon its property. One of them is called the "Manufacturer's building," the other one the "Factory building." The building constructed on the Garrett building site and leased to Reid, Murdoch & Co. cost \$408,573.26. The manufacturer's building cost \$353,946.14. The cost of the factory building is not given. We do not find in the abstract the specific orders and directions of the board of trustees authorizing the construction of the factory building. It only appears to have been constructed by authority of the board. Neither is it shown at what time the buildings were completed. At a meeting of the board of trustees May 27, 1903, a resolution was adopted authorizing "the proper officers of the board of trustees" to arrange for funding so much of the floating indebtedness of appellee as may be deemed expedient.

On May 25, 1899, Dr. Shepherd made a report to the annual meeting of the board of trustees of the appellee purporting to show receipts and disbursements for the preceding year. In that report he



charges himself with having received \$22,783.66 and having paid out \$28,848.87. The evidence shows that he also made a report of receipts and expenditures May 29, 1901, but this report is not to be found in the abstract or the record. Crandon, secretary of the board, testified, that in that report Dr. Shepherd credited himself with the payment of \$12,136.72 interest. We find no other report of receipts and expenditures by him until May 24, 1905, when he made a report purporting to show receipts and disbursements for the two years from 1903 to 1904, and 1904 to 1905. The report shows receipts for the year 1903 to 1904 of \$201,434.81, and expenditure of all of that sum except \$7,541.53 balance on hand. In his report for the year 1904 to 1905 Dr. Shepherd charges himself with \$111,330.67, and credits himself with disbursing all that sum except \$17,812.11. He does not charge himself in any of these reports with receipts of moneys borrowed for the construction of the buildings erected, and testified on the trial that the building account was not included in his reports. F. P. Crandon was one of the trustees of appellee and was secretary of the board. He testified that he examined the reports made by Dr. Shepherd for the board, and compared the disbursements with the vouchers, but he never examined the books of the treasurer, or anything else than the report, to verify the correctness of the receipts.

It is apparent from the items reported by Dr. Shepherd as making up his receipts and disbursements that moneys received on account of the building operations were not included. It would seem that this must have been known by the board of trustees, for the authorized cost of the construction of the Reid-Murdoch Building and the manufacturer's building was more than one-half million dollars. Their actual cost, when completed, was more than three-quarters of a million dollars. There is no evidence of any source from which this money could have been obtained except by the negotiation of loans. That Dr. Shepherd did, during the progress of the building operations, borrow money, and give notes of the corporation therefor, was known to the board of trustees. Some of such notes were paid off by appellee, and the proof tends to show that these notes were given and paid off with the approval of the board of trustees. Eight notes, aggregating a large sum of money, were given to the Illinois Trust and Savings Bank between August 1, 1898, and November 16, 1898. Three notes were given to the State Bank of Chicago between May 4, 1899, and October 1, 1901. One note for \$2,000 was given to H. F. Fisk, trustee for Mrs. Coan, in 1897. January 14, 1899, a note for \$1,400 was given the Woman's Foreign Missionary Society, and February 3, 1903, a note for \$6,000 was given the same organization. August 1, 1900, a note for \$1,100 was given Jennie P. Fisk, and September 25, 1901, another for \$2,218 was given the same party. With the exception of the note to H. F. Fisk, trustee, all these notes were executed after the building operations had been entered upon. They were all signed

by appellee, by Dr. Shepherd, treasurer. As we have said, the proof tends to show appellee had knowledge of these transactions.

It will be observed that when Dr. Shepherd was authorized to negotiate a loan for the construction of the Reid-Murdoch building, he was also authorized to secure temporary loans pending its negotiation. The evidence tends to support the conclusion that he exercised this authority and borrowed money upon the notes of the corporation, from small amounts up to considerable sums, from time to time. If these temporary loans were ever consolidated in one amount to one person or corporation, the record does not show it. The record of the board of trustees authorizing the construction of the manufacturer's building is not as specific in its authority to Dr. Shepherd to borrow money as was the record with reference to the Reid-Murdoch building. With reference to the manufacturer's building, Dr. Shepherd, in a report made to the trustees May 29, 1901, recommended the construction of the building at a cost approximating \$300,000, and that authority be given to execute a lease for it, and authority be given, also, "looking toward the procurement of a fund for the purpose of building." A motion was adopted by the trustees "that said report be approved and that its several recommendations be concurred in." It was not necessary that authority might be conferred by the appellee on Dr. Shepherd to borrow money that the evidence of such authority should be reduced to writing and preserved. The failure to preserve in the minutes or other writing the evidence of a corporation's act conferring authority upon its agent to borrow money would not invalidate authority conferred. If there is a writing or record of the authority, it is the most satisfactory evidence to establish that fact, but where the evidence is not so preserved, then it may be proven by any legitimate testimony, direct or circumstantial, competent under the rules of evidence to prove a fact not evidenced by any writing or record. *Bank of United States v. Dandridge*, 12 Wheat. 64, 6 L. Ed. 552. That a record was not always made of the acts of the board of trustees is indicated by the fact that no record was made of any action of the board, so far as this record shows, for the construction of the factory building. It certainly cannot be presumed that such an important and expensive work could be done without the knowledge of the board of trustees, and if it did know of the work and permitted it to go on, and money to be borrowed for that purpose, the corporation would be deemed to have ratified the acts of the agent borrowing the money used for the construction of the building. It is a circumstance also proper to be considered with all the other evidence in determining whether the board of trustees had, in fact, authorized Dr. Shepherd to borrow money.

That the indebtedness incurred by the corporation in its building operations was not all paid off prior to May 27, 1903, by merging all the corporation's indebtedness into one or more loans on long time, is inferable from the fact that on the last-mentioned date the board of

trustees adopted a resolution authorizing its proper officers "to arrange for funding so much of the floating indebtedness of the institute as it may deem to be expedient." Two of the notes sued on were given before that resolution was adopted and one of them afterwards. In his report of May 24, 1905, which covered a period of two years previous, Dr. Shepherd stated that his work in connection with the negotiation of loans and the development of the corporation's property had made very heavy demands on his time and vitality; that he wished in the near future to ask to be relieved of these cares and duties; that no special statement had been previously made in regard to the various building operations, and not being himself an accountant, he requested that a thorough examination of his accounts be made by Mr. Crandon and presented to the board of trustees at its convenience. Pursuant to this request Crandon was directed to audit the accounts of Dr. Shepherd and authorized to employ such help as he deemed necessary in doing the work. Thereafter Crandon reported, as the result of his investigation, that while Dr. Shepherd was treasurer of appellee, and up to September 30, 1905, he had received \$1,786,315.22, and that, including the balance which his accounts showed was on hand, he had disbursed the same amount. Crandon testified, however, that all of this balance was not on hand as a matter of fact, and that Dr. Shepherd was \$11,000 short in his accounts with appellee. It is a reasonable inference to be drawn from the proof that the principal part of the large sum of money received by Dr. Shepherd was from loans negotiated by him. In his report for the year 1903 and 1904 Dr. Shepherd credits himself with having paid \$35,476.54 interest, and in the report for the year 1904 and 1905 he credits himself with having paid \$32,567.91 interest. These reports were not made until after the notes sued on were given, but the authority of Dr. Shepherd to pay these large sums of interest does not appear to have been questioned by the board of trustees. It is a circumstance proper to be considered in connection with the previous acts of the board of trustees proven upon the question whether the board had authorized Dr. Shepherd to borrow money and issue notes. The evidence also tends to show that moneys received by Dr. Shepherd as treasurer of appellee were deposited in the State Bank of Chicago to the credit of appellee and were checked out by him, and no one else had any authority to draw checks against the account.

We might refer to other circumstances in evidence, but in our opinion the foregoing is sufficient to have entitled appellant to have the case submitted to the jury upon the question whether appellee had given Dr. Shepherd, in his capacity as treasurer and "business agent" or "business manager," actual authority to borrow money and give notes therefor, or whether, in the absence of actual previous authority to do so, he had borrowed money and given notes with the full knowledge and approval of the corporation. On a motion to direct a verdict the court is not permitted to weigh the evidence. If there is any



evidence, which, with all reasonable inferences to be drawn therefrom, fairly tends to prove the plaintiff's case, it should be submitted to the jury. *Woodman v. Illinois Trust & Savings Bank*, 211 Ill. 578, 71 N. E. 1099; *Libby, McNeill & Libby v. Cook*, 222 Ill. 206, 78 N. E. 599.

We are also of opinion there was sufficient evidence to entitle plaintiff to have the case go to the jury upon the question whether, in the absence of any authority in Dr. Shepherd to borrow the money and give the notes sued on, he did borrow it and appellee received the use and benefit of it. The evidence warranted the conclusion that the money received for the notes sued on was deposited in the bank to the credit of appellee. This, in connection with the other proof as to the manner in which the money was drawn out, tends to show that appellee received the benefit of it. It is, of course, not conclusive of that fact, but, standing alone, tends to support it. This court has held that where a principal actually receives the benefit of money procured by the unauthorized acts of its agent, the principal will be liable in the amount it has received the benefit of. *First Nat. Bank of Las Vegas v. Oberne*, 121 Ill. 25, 7 N. E. 85; *Fay v. Slaughter*, 194 Ill. 157, 62 N. E. 592, 56 L. R. A. 564, 88 Am. St. Rep. 148.

We are inclined to agree with the trial and appellate courts that there is not sufficient evidence in this record to go to the jury upon the question whether appellee was liable by reason of having held out Dr. Shepherd to the public as possessing apparent authority to borrow money and issue notes of the corporation. In *Merchants' Nat. Bank v. Nichols & Shepard Co.*, 223 Ill. 41, 50, 79 N. E. 38, 40, 7 L. R. A. (N. S.) 752, it was said: "A principal may be bound to the extent of the apparent authority which he has conferred upon his agent, but that is because he has held the agent out to the public as possessing the power which the agent exercises. In such a case the principal may bind himself by causing others to believe the powers of the agent to be greater than those actually conferred (*Maxey v. Heckethorn*, 44 Ill. 437), but the acts which amount to such representation of the agent's authority must be known to the party setting them up if he intends to avail himself of them. *Rawson v. Curtiss*, 19 Ill. 456. A party dealing with an agent must prove that the facts giving color to the agency were known to him when he dealt with the agent. If he has no knowledge of such facts he does not act in reliance upon them, and is in no position to claim anything on account of them." To the same effect is *Jackson Paper Manf. Co. v. Commercial Nat. Bank*, 199 Ill. 151, 65 N. E. 136, 59 L. R. A. 657, 93 Am. St. Rep. 113. Where reliance is placed upon the apparent authority of an agent to bind the principal by giving notes, the assignee of such notes, even though they were received before maturity, would occupy no better position than the payee, for if the payee was not authorized to take the notes, he could not confer authority upon his assignee to col-

lect them. We think the evidence does not fairly tend to show that Fisk knew of and relied upon the acts of appellee which it is now claimed invested Dr. Shepherd with apparent authority to borrow the money and give the notes. A case of squandering or appropriating to his own use, by an agent or officer of a corporation, moneys borrowed in the name of the corporation, but without reference to its corporate needs and purposes, is not presented for decision by this record.

The evidence, we think, was sufficient to justify submitting to the jury the liability of appellee on three grounds: First, whether the money was borrowed by authority, express or implied, of the corporation; second, if not borrowed in pursuance of authority previously given, did the corporation, after knowledge of the fact of its being borrowed, approve or ratify it? Third, if it was borrowed without previous authority, and was not afterwards, with knowledge, ratified by the corporation, did it receive the use and benefit of the money? It will, of course, be understood that we do not intend, by what is said herein, to express any opinion as to the weight of the evidence. What we have held is, that upon certain grounds mentioned the evidence was sufficient to require the case to be submitted to the jury. The judgments of the Appellate and municipal courts are reversed and the cause remanded.

Reversed and remanded.

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#### IV. Contracts of Suretyship and Guaranty<sup>5</sup>

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##### J. P. MORGAN & CO. v. HALL & LYON CO.

(Supreme Court of Rhode Island, 1912. 34 R. I. 273, 83 Atl. 113.)

Exceptions from Superior Court, Providence and Bristol Counties; Willard B. Tanner, Presiding Justice.

Action by J. P. Morgan & Co. against the Hall & Lyon Company. From a decision for defendant, plaintiffs bring exceptions. Exceptions sustained, and defendant given an opportunity to show cause why judgment should not be entered for plaintiffs.

VINCENT, J. This is an action at law, brought by J. P. Morgan & Co. to recover from the defendant corporation damages for breach of its written guaranty of a letter of credit issued by the plaintiffs to Emily Alpers; the guaranty being signed by the defendant corporation, by its then treasurer, George C. Lyon. The guaranty is as follows: "Guarantee. Letter of Credit No. N———. New York, Aug. 19, 1907. Whereas, J. P. Morgan & Co. have given to Miss Emily

<sup>5</sup> For discussion of principles, see Clark on Corp. (3d Ed.) §§ 56, 57.

Alpers their circular letter of credit, No. N—— for £200, or Fcs. 5,050, we hereby guarantee and agree, on demand, to pay said J. P. Morgan & Co., the amounts drawn against said letter of credit, together with usual charges. In case this credit be either lost or stolen, we hereby authorize J. P. Morgan & Co. to send the usual circular to their correspondents, notifying them of the loss, and to take such precautions as they may deem advisable for the prevention of fraud, agreeing to pay any expenses attending the same, and in case of the cashing of any drafts by any banker, under the usual precautions, and before the receipt of any circular, we agree to indemnify J. P. Morgan & Co. for any loss therefrom. Hall & Lyon Co., Geo. C. Lyon, Treasurer." The letter of credit was issued in August, 1907, and was for £200 sterling. Against this letter of credit six drafts were drawn, three of which drafts are still unpaid, to wit, one for £17, one for £54, and one for £100. The amount due on this letter of credit in United States money, at the then current rates of exchange, was \$845.98, not including interest.

The case was tried in the superior court without a jury, and a decision was rendered for the defendant, whereupon plaintiffs filed their bill of exceptions upon two grounds: (1) That the said decision was against the law; and (2) that said decision was against the evidence and the weight thereof. The defendant contends that, the Hall & Lyon Company being a trading corporation, the act of its treasurer in signing the guaranty was without authority, and so simply an act for the accommodation of a third party to whom the letter of credit was issued, and therefore that it was ultra vires as to the defendant corporation, and also that the plaintiff took such guaranty with notice of its character. The plaintiffs deny both of these propositions, and claim: (1) That the guaranty was issued by the treasurer of the defendant company under full apparent authority to bind the defendant company; that his act was not ultra vires, there being no evidence that such guaranty was for the accommodation of a third party; (2) that the plaintiffs took the guaranty in good faith without notice, actual or constructive, there being nothing surrounding the transaction to suggest inquiry as to the validity or purpose thereof; and (3) that the defendant knew that the guaranty was accepted in good faith, and in the belief that it would be recognized, and the drafts drawn on the letter of credit would be paid by the defendant, and therefore the defendant became bound to make such payment. There is nothing in the testimony tending to show whether or not Emily Alpers was in any way or manner connected with the defendant company.

It is, no doubt, the general rule that a corporation is not ordinarily bound by a contract of guaranty for the benefit of third parties, but that such guaranty may be given in the accomplishment of any object for which the corporation was created, or when the particular transaction is reasonably necessary or proper in the conduct of its busi-



ness. Clarke & Marshall, Private Corporations, §§ 184-184c; Thompson on Corporations, §§ 2218-2226.

There is also good authority for the position that whenever an act may, under any circumstances, be reasonably necessary to carry out the purposes of incorporation, the party dealing with the corporation has a right to assume, without notice to the contrary, that the act is binding upon it. Green's Bryce's Ultra Vires, p. 37 et seq., 40a. The defendant corporation might properly guarantee a letter of credit under some circumstances, as, for instance, if it were sending some one abroad to purchase goods; and the plaintiffs would have the right to assume, both from previous dealings with the defendant and from lack of notice, that the guaranty was in furtherance of the defendant's legitimate business. Taking into consideration the well-known fact that drug stores keep on hand and offer for sale a large variety of articles which cannot be classified as drugs, and the further fact that women have been employed, in recent years, in a great variety of occupations, including heads of departments, buyers, and in many other positions connected with mercantile business, we do not think that the issuance of the letter of credit in the name of a woman would be sufficient to put the plaintiffs upon inquiry.

There was nothing in the transaction which was calculated to excite the suspicion that the letter of credit was a matter of accommodation, and there was no testimony upon that point. So far as appears, the letter of credit was issued and the guaranty obtained in good faith from an officer of the defendant company having, apparently, the required authority to act as he did. The plaintiffs had no actual or constructive notice that the letter of credit was to be used for purposes unconnected with the defendant's business. Under these conditions the plaintiffs would be entitled to the presumption that in guaranteeing the letter of credit the treasurer of the defendant company was acting within his authority.

We do not think that there is anything in the case of Cook v. American Tubing & Webbing Co., 28 R. I. 41, 65 Atl. 641, 9 L. R. A. (N. S.) 193, which should restrain the court from finding the defendant liable. In that case certain claims were allowed and certain others disallowed. Claims which bore upon their face the evidence that the transaction was for the accommodation of third parties were disallowed, while others which did not bear such evidence, and were not surrounded by circumstances calculated to arouse suspicion, were allowed. The court said in that case: "We need not consider the question whether the assignment of accounts was a form of security which the general manager was authorized to make. Whether he could do so or not, \* \* \* there was nothing in his offer to do so which was calculated to excite the suspicion that the loan was required for any purpose other than the ordinary uses of the webbing company. Whether, if the security had been real, the complainant could hold it,

is not now material. The loan was made in good faith to an officer having apparent authority to contract it, the lender had no actual or constructive notice that it was procured with fraudulent intent to appropriate the money lent, and we must consider the claim a valid one against the webbing company and its assets in the hands of the receivers." This language of the court seems to us to cover the case at bar. There was nothing in the transaction which was calculated to excite the suspicion or apprise the plaintiffs that the proceeds of the letter of credit were to be devoted other than for the purposes of the defendant company.

The defendant contends that there has been no breach of contract by the defendant; that assuming that the contract upon which the suit is brought was a contract within the power of the corporation to make, and within the power of the treasurer of the corporation to make in its behalf, upon the record, there is no liability from the defendant to the plaintiff. With this contention of the defendant we cannot agree. The defendant in and by its guaranty promised to pay to the plaintiff "the amounts drawn against said letter of credit." Letters of credit only become useful and serviceable to the traveler, through the general credit of the party issuing the same, or through some arrangement made with bankers within the territory to be traversed. In the case before us it is admitted that Emily Alpers received upon her letter of credit the full sum for which the same was issued. The conclusion is therefore inevitable that she received the money by virtue of some arrangement between the plaintiffs and their correspondents abroad. What those particular arrangements were does not seem to us to be important in the present controversy.

The plaintiffs undertook to furnish to Emily Alpers a letter of credit for a certain amount of money, to be drawn by her at such times and in such amounts as she might determine, and this undertaking the plaintiffs performed. Under these conditions the defendant guaranteed to pay such amounts to the plaintiffs as might be drawn upon said letter. The consideration for the guaranty was to make available to Emily Alpers the sum of money expressed in the letter, and inasmuch as there has been no failure of consideration we cannot see why the defendant should not pay the balance due to the plaintiffs in accordance with its agreement.

The plaintiffs' exceptions are sustained, and an opportunity will be given to the defendant to appear and show cause, on June 3, 1912, at 10 a. m. why judgment for the plaintiffs in the sum of \$845.98, with interest, should not be entered.

## V. Contracts of Partnership \*

## BREINIG v. SPARROW.

(Appellate Court of Indiana, 1907. 39 Ind. App. 455, 80 N. E. 37.)

Appeal from Circuit Court, Knox County; O. H. Cobb, Judge.

Action by George M. Sparrow against Henry L. Breinig and others. From a judgment for plaintiff, defendants appeal. Affirmed in part, and reversed in part.

ROBY, P. J. Action by appellee against appellants for the foreclosure of mechanic's lien and personal judgment. Benjamin G. Hudson and the Vincennes Citizens' Street Railway Company appealed from the judgment for \$3,630 rendered against them and their co-appellants Breinigs. The errors assigned by each of said appellants is in the overruling of their separate motions for a new trial, and the grounds stated in such motions are that the finding of the court was not sustained by sufficient evidence and was contrary to law. Appellee, on May 10, 1904, entered into a building contract, in writing, by which he agreed to construct a "casino" or electric park, Fairview avenue, Vincennes, Ind., in accordance with certain plans and specifications and in consideration of \$3,108.75, 75 per cent. of said price to be paid upon estimates during the construction, and the residue at the completion of said building. The contract was signed by H. L. Breinig and appellee. It is sought in this action to hold appellants for the contract price of said building upon two theories set up in different paragraphs of complaint: First, that they held themselves out as partners with the Breinigs, under the firm name and style of "H. Breinig." Second, that they were in fact associated with him in said enterprise and therefore liable with him under said name. There was a trial by the court, without a jury, and a finding for appellee as against the three Breinigs and appellants, and each of them, in the sum of \$3,630, for which sum judgment was accordingly rendered. Before executing the contract sued upon, appellee read a contract which had been theretofore executed and which was in the words and figures following:

"Terre Haute, Ind., May 2, 1904.

"This indenture made as above dated between Henry L. Breinig, Chas. O. Breinig, and Geo. J. Breinig, all of Terre Haute, Indiana, their successors and assigns, first parties of, and the Vincennes Citizens' Street Railway Company of Vincennes, Indiana, its successors and assigns, second party, witnesseth:

"Whereas, said first parties have leased from one Fred Fossmeier, of Vincennes, Indiana, a certain tract of ground on Fairground avenue

\* For discussion of principles, see Clark on Corp. (3d Ed.) §§ 56, 57.



in said city and situated also on the Street Railway, and Whereas, it is the intention of said parties of the first part to conduct upon said ground various amusements consisting of a theatre, merry-go-round and other forms of amusement, and Whereas, in the conduct of said business it is presumed that certain benefits to the Street Railway will be derived, and Whereas, in order to procure funds for the establishment and conduct of said amusement it is necessary that aid and assistance be extended said first parties by said second party. Now, therefore, this agreement witnesseth:

"First. That first parties in procuring the help and assistance of said second party either by endorsement or otherwise, hereby obligate themselves to fully pay off any and all obligations guaranteed or endorsed by second party. Second. That in the conduct of said amusements above referred to the first parties hereby agree to establish and maintain only first class respectable lines of amusements. Third. That said first parties agree that said amusements shall be carried on under the name of the 'Electric Park,' and that the entrance fee thereto shall in no case be less than 10c. per person, and that when patrons who have walked to said park and paid 10c. admission thereto, said amount shall accrue wholly to first parties, and that when patrons who shall have ridden to said park and paid 15c. thereto including transportation and admission of said latter amount, the sum of 7c. per passenger shall accrue wholly to said first parties and the sum of 8c. per passenger to said second party, settlement to be made weekly, and as the essence of this agreement is mutual profit, the said first parties agree to use their best endeavor to induce travel to said park over the lines of railway of said party. Fourth. That as mutual results beneficial to all parties hereto are presumed to follow the installment of said park, it is hereby mutually agreed that all parties hereto shall work in harmony to that end in all things relating thereto. Fifth. That neither party hereto is to sell, assign or transfer any rights hereunder without the written consent of the other, but this contract may be altered or amended at any time by both parties mutually consenting in writing. Sixth. That said second party is to wire said park for light and power purposes at its expense and furnish current to said first parties for power and light at 6c. per 1,000 K. W. settlement to be made weekly. Seventh. That for and in consideration of the sum of one (\$1.00) dollar and other considerations herein named, this contract and agreement is signed by all parties hereto this 2nd day of May, 1904. Eighth. That this agreement be and remain in full force and effect from this date until October 1st, 1906. Executed in duplicate.

Henry L. Breinig.

"Charles O. Breinig.

"George J. Breinig.

"Vincennes Citizens' Street Ry. Co.,

"By B. G. Hudnut, Pt."

This instrument does not contain an agreement in express terms by the railway company to make advances, but such arrangement is impliable, and the agreement relative thereto might rest in parol.

Partnership is defined as "the relation subsisting between two or more persons who have contracted together to share as common owners the profits of the business carried on by all or any of them on behalf of all of them." Shumaker, Partnership (2d Ed.) § 1; Meehan v. Valentine, 145 U. S. 611, 12 Sup. Ct. 972, 36 L. Ed. 835. "It is now well established that the fundamental rule to be observed in determining the existence of a partnership is that regard must be paid to the true contract and intention of the parties as appearing from all the facts of the case." Shumaker, supra, § 13; Bradley v. Ely, 24 Ind. App. 2, 56 N. E. 44, 79 Am. St. Rep. 251. The intention which controls in determining the existence of the relation, is the legal intention deducible from the acts of the parties. If they intend to do the things which in law constitute a partnership, then they are partners, although their purpose was to avoid the creation of such relation, and they have carried it to the extent of expressly stipulating that they are not to be partners. Bradley v. Ely, supra; Shrum v. Simpson, 155 Ind. 160, 57 N. E. 708, 49 L. R. A. 792; Shumaker, supra, § 13. "The ultimate and conclusive test of a partnership is the co-ownership of the profits of the business. If there is a community of profits, a partnership follows. Community of profits means a proprietorship in them as distinguished from a personal claim upon the other associate. In other words, a property right in them from the start in one associate as in the other." Bradley v. Ely, supra; Macy v. Combs, 15 Ind. 469, 77 Am. Dec. 103; Emmons v. Newman, 38 Ind. 372.

The doctrine of estoppel operates against one who knowingly suffers himself to be represented as a partner in a particular firm, and renders him liable to one who is thereby induced to give credit to the firm. Booe v. Caldwell, 12 Ind. 12; Dailey v. Coons, 64 Ind. 545; Thompson v. Bank, 111 U. S. 529, 4 Sup. Ct. 689, 28 L. Ed. 507; Shumaker on Partnerships, § 35. There can be no basis for an estoppel where the party seeking to raise it knew the truth from the beginning, therefore, where a creditor knows of the holding out, but also knows that the parties are not partners, no estoppel in his favor arises. Booe v. Caldwell, supra; Shumaker, supra, p. 73, § 35. Knowledge by the creditor that the real partners have agreed to indemnify the party lending his name, does not prevent an estoppel against him, but so holding himself out he becomes primarily liable to a creditor and must seek his indemnity from those who promised it. Shumaker, supra, p. 67, § 35; Lindley, Partnership, p. 41. A corporation has no power to enter into a contract of partnership unless such power is expressly conferred. Pearce v. Madison, etc., R. Co., 62 U. S. 441, 16 L. Ed. 184; Pittsburg, etc., R. Co. v. Keokuk, etc., Co., 131 U. S. 371, 9 Sup. Ct. 770, 33 L. Ed. 157; Clark & Marshall, Corporations, § 185;



Geurinck v. Alcott (Ohio) 63 N. E. 714. Exceptions to the rule arise when the corporation is expressly authorized by its charter to make such contracts. Butler v. American, etc., Co., 46 Conn. 136; Clark & Marshall, Corporations, § 185b, p. 493. Nor does it apply to prevent the law from imposing upon the corporation the liability of a partner as to third persons by reason of a contract made by it in furtherance of the objects of its creation, for the law may impose such a liability not only when there is no intention to become a partnership, but also when no contract of partnership could have been made. Cleveland, etc., Co. v. Courier Co., 67 Mich. 152, 34 N. W. 556; Catskill Bank v. Gray, 14 Barb. (N. Y.) 471; French v. Donohue, 29 Minn. 111, 12 N. W. 354; Clark & Marshall, Corporations, § 35b, p. 494.

The contract above set out was intended to further the business of the appellant corporation. Its terms and the facts proven show that it was made for the purpose of creating additional traffic. If the park had been put in operation and proven a source of income to the corporation, the contract thus executed by one party and its benefits received by the other, would have been binding upon both, nor is the operation of such park and the receipt of such additional income essential to the liability which is based upon the principle of estoppel. If a corporation makes a contract which is merely ultra vires and not illegal, and others have thereby been induced to expend money, the corporation will be bound by its contract. State Board, etc., v. Citizens', etc., R. Co., 47 Ind. 407, 17 Am. Rep. 702; Wright v. Hughes, 119 Ind. 324, 21 N. E. 907, 12 Am. St. Rep. 412; Franklin National Bank v. Whitehead, 149 Ind. 560, 49 N. E. 592, 39 L. R. A. 725, 63 Am. St. Rep. 302; Bedford, etc., R. Co. v. McDonald, 17 Ind. App. 492, 46 N. E. 1022, 60 Am. St. Rep. 172; Valparaiso v. Valparaiso, etc., Water Co., 30 Ind. App. 316, 65 N. E. 1063. It is declared in the contract that "the essence of this agreement is mutual profit"; "that as mutual results beneficial to all parties hereto are presumed to follow the installment of said park"; "that when patrons who shall have ridden to said park and paid 15c. thereto including transportation and admission of said latter amount, the sum of 7c. per passenger shall accrue to said first party and the sum of 8c. per passenger to said second party." The agreement thus expressed is to share certain profits arising from the conduct of a joint undertaking. To the creation of such profits each party makes certain contributions, and whatever relation exists is limited to such enterprise. Heshion v. Julian, 82 Ind. 576.

It is not necessary to the existence of a partnership that both parties own a part of all property contributed to the common enterprise. The use of property to which one party retains title may be given by him as the whole or part of his contribution to the joint enterprise. The lawyer retains title to his library, the merchant to his furniture and fixtures, the landowner to his building, adding to the capital of



his firm the amount that the use of such property may be worth to it, the essence of the business thereafter carried on being mutual profit. It is expressly stipulated that the fund created by carrying and admitting persons to the park shall be divided; both railway company and park management have an interest therein. To produce this fund is the ultimate purpose of the arrangement. The use of the transportation facilities possessed by the railway company is an essential factor in its creation. The existence of a park and the operation of amusements calculated to attract the public is also an essential factor thereto. The park company would not be liable for operating expenses of the railway, any more than the lawyer who used the library owned by his associate would become thereby liable for the purchase price of the books or the cost of insuring them, in the absence of a contract creating such liability. Neither would the railway company be liable for the operating expenses of the park in the absence of some agreement thereto, but the contribution to the business which the railway agrees to make is not limited to the use of its line. In order to consummate a common enterprise "it is necessary that aid and assistance be extended said first parties by said second party." The stipulation follows that "the first parties, in procuring the help and assistance of said second party, either by indorsement or otherwise, hereby obligate themselves to fully pay off any and all obligations guaranteed or endorsed by said second party." In the end, the cost of the improvement was to be borne by the owners of the park. What the railway company was to do in the way of assisting in the procurement of funds "for the establishment and conduct of said amusement" is not specifically stated. That it was to do something is clearly implied. The subsequent conduct of the parties, therefore, became relevant both as tending to show what construction they placed upon the contract and for the purpose of affording evidence as to those terms which were not reduced to writing.

✓ The grounds upon which the building was erected by appellee were owned by Frederick Fossmeier. They were leased by him to the Breinigs on April 4, 1904. Appellant Hudnut was the president and principal owner of the railway company. Mr. Henry was its general manager, Mr. Gordon, its secretary and treasurer; he was also private secretary for Mr. Hudnut, and these three gentlemen constituted its board of directors. Hudnut selected the Fossmeier land as the most available which could be procured for the purpose, having first examined other tracts and offered to lease ground belonging to the Fair Association. He told Breinig to go to a certain architect for plans for the building; Breinig went there and told the architect that Hudnut sent him. When bids were submitted, Breinig took them to Hudnut, who told him to accept that of appellee, which was the lowest. Breinig had no capital of any consequence and told Hudnut that it would take \$5,000 or \$6,000 to make the improvements. Hudnut told him

to go ahead and make them and subsequently had the written contract above set out, prepared by his own attorney. It took about five weeks to complete the building, during which time Mr. Henry was on the ground about every day, and exercised a direct supervision over the improvement, carrying such supervision to the extent of changing the plan. When the building was completed Hudnut examined it and directed ceiling to be put on. Hudnut examined it, and then told Breinig, who was at Terre Haute, that the building was done. He signed a note with Breinig for \$1,000 "on a merry-go-round." He also advanced Breinig \$500 taking his note, and told him that he and the railroad company would sign a note for \$3,000, if he (Breinig) could procure the loan. Breinig was unable to get the liquor license. The building was then moved across the corporation line, Henry directing where it should be placed. Still being unable to procure the license, Hudnut "said he did not want to put any more money in the enterprise. He had put in as much as he cared to put in." Appellee knew that Breinig was never "worth anything," and that Hudnut was "a man of means." Breinig told him that "Hudnut was to finance the whole thing," and showed him the contract above set out, which Sparrow read, after which he entered into the building contract, constructed the Casino and did other work at the instance of Breinig, Hudnut, and Henry, the value of which is included in the judgment and no part of which has been paid.

It is not necessary upon these facts to determine whether or not, taken in connection with the written contract, they are sufficient to justify a finding that the railway company was a joint party with the Breinigs to the Sparrow contract for the reason that the conduct of the railway company was through its officers. The inspection of the contract in question by appellee does not conclusively establish knowledge on the part of the latter that the railway company was not a party to the enterprise. Had the court found that Sparrow did know that no partnership relation existed, it would then become necessary to determine whether there was an actual partnership, but the finding of the court carries with it a finding within the issues that he did not have such knowledge, and we hold without hesitation that one who causes a contract to be so prepared as that a person of ordinary understanding reading it is thereby induced to believe that a partnership exists, and whose conduct, extrinsic to the writing, accords with such conclusion, cannot subsequently, after a third party has parted with value upon the strength of the belief thus induced, be permitted to deny liability. The practical interpretation placed upon this contract by its officers justified appellee in relying upon it as evidencing the responsibility of the railway company. During the entire transaction Hudnut was treated by the corporation so as to indicate that such contract was subject to the interpretation which he might place upon it. Its board of directors, its officers, and the majority of its stockholders,

participated in both the enterprise and interpretation of the contract. Having thus induced appellee to incur the expense incident to the construction of the building in accordance with the contract which was also thus caused to make, it is bound to him therefor.

The railway company being held liable, the proposition that an officer of a corporation, acting without authority, binds himself is not material. In its absence the facts do not seem to us sufficient to establish the liability of Hudnut.

Judgment reversed as to appellant Hudnut, and affirmed as to other appellants.

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## VI. Power of Corporation to Acquire and Hold Stock in Another Corporation <sup>7</sup>

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### STATE v. MISSOURI PAC. RY. CO.

(Supreme Court of Missouri, 1911. 237 Mo. 338, 141 S. W. 643.)

In Banc. Quo warranto by the State, on the information of the Attorney General, against the Missouri Pacific Railway and others. Ouster refused, and defendants discharged.

VALLIANT, C. J. The information is in quo warranto. The respondents are Missouri corporations. The business for which each was incorporated is indicated by its corporate name, a railroad company, two coal mining companies, and an elevator company.

The charge in the information is that the railroad company has acquired the capital stock of the three other corporations, and is engaged in conducting the business for which they were incorporated. More specifically stated, the charge is that the Western Coal & Mining Company was organized under the laws of this state in 1879, with capital stock of \$500,000, for the purpose of carrying on a general coal and mining business in Missouri, Kansas, and elsewhere, with power to purchase, lease, or otherwise acquire mineral and other lands for the purpose of mining coal and other minerals, buying and selling coal, etc., and owning and operating machinery and appurtenances necessary to carry on that business, and that, after its organization, the corporation entered upon the business for which it was chartered, and continued to conduct the same until the acquisition of its capital stock by the Missouri Pacific Railway Company, whereupon it ceased to perform its functions, and the business has since and is still being conducted alone by the railroad company, to the injury of the interests and welfare of the people of the state. Like specifications are made in re-

<sup>7</sup> For discussion of principles, see Clark on Corp. (3d Ed.) §§ 56, 57.



lation to the Rich Hill Coal & Mining Company, and, varying only in reference to the character of the business, relating also to the Kansas-Missouri Elevator Company. The conclusion from those facts drawn in the information is that the two coal companies and the elevator company have lost their integrity and individuality, and are rendered incapable of exercising the franchises granted by their respective charters, that each had become a mere cover for the unlawful exercise of power by the railroad company, and their further existence is of injury to the people of the state. The prayer is that the two coal companies and the elevator company be ousted of their charters, that the railroad company be ordered to cease operating the business of those three companies, and, failing to heed such order, that it be ousted of the corporate rights granted by its charter.

The respondents file a joint answer to the following effect: They admit the organization of each of the corporations as stated in the information and the purpose for which it was organized, and they admit that a majority of the capital stock of the three other companies is owned by a trustee who holds the legal title thereto for the use and benefit of the railroad company, but aver that there are four other persons who each own at least one share of the stock. Referring to the averment in the information to the effect that the railroad company holds its charter from the state and has only the powers granted to it as a railroad company by the laws of the state which are only such powers as are necessary, convenient, and incident to the construction, maintenance, and operation of a railroad as a public highway, and that, under the Constitution, it can engage in no business other than that expressly authorized by the charter or the law under which it may have been organized, the answer avers that the railroad company has offended in no respect the provisions of the law referred to, and has not gone beyond the lawful power conferred by its charter; that the acquiring of the stock in the coal companies was for the purpose only of securing for its use in operating its railroad the necessary supply of coal for fuel, and the acquiring of the stock in the elevator was to facilitate the shipping and transportation of grain over the railroad. They deny that since the acquisition of the stock by the railroad company the coal companies and the elevator company have ceased to do business under their respective charters, or that such business is or has been conducted by the railroad company; on the contrary, they aver that since the acquisition of the stock, as before, the business of the coal companies and the elevator company have been conducted exclusively by their respective boards of directors duly elected by the stockholders. They deny that there has been any abuse of their charter powers or any conduct on the part of the directors injurious to the interest or welfare of the people of the state, or that the interests or welfare of the people would be promoted by a dissolution of the corporations named or a forfeiture by the railroad company of its beneficial interest in the stock of the other companies.

To that answer the Attorney General filed a reply, in which after denying that any persons other than the trustee for the railroad company owned any of the stock, and denying that the stock was acquired for the purposes stated in the answer, went on to aver that since the acquisition of the stock in the coal companies the railroad company, "through the management, conduct, and control of the said coal companies, engaged in the business of selling coal to the general public, and did sell large amounts through and under the name of said coal and mining companies to the general public in Missouri and elsewhere." An averment of like character was made in reference to the business of the elevator company. These averments differ from those in the information, in this, to wit: In the information it was stated that the railroad company itself was under cover of the charters of these other companies carrying on the business of mining and marketing coal and a general warehouse and elevator business, whereas the averments in the reply are that the railroad company was doing those acts through the management of the coal and elevator companies by virtue of its ownership of the stock in those companies. On motion of the respondents, the court struck out those averments in the reply, construing them to be the pleader's inference from the fact of the ownership of the stock, and, since the ownership of the stock was admitted in the answer or return, the inference to be drawn was but a legal conclusion.

The state then moved for judgment on the pleadings, and that is the form in which the cause is now submitted for final judgment. For the purposes of this motion the statements in the answer (or return) of respondents must be taken as true, and the statements in the information, admitted by the answer, will also be taken as true. The legal conclusions that either party draws from those facts are open for discussion.

The organizations of the corporations as stated in the information, and the several purposes for which they were, respectively, organized, are admitted, and it is also admitted that the majority of the stock in the coal companies and in the elevator company is held by a trustee for the railroad company. The language of the answer perhaps justifies the inference, also, that all the stock in those companies except four shares in each is held by a trustee for the railroad company, and that those four shares are held by individuals to enable them to qualify as directors as the law requires. Against those admissions, we have the statements in the answer that the purpose of the railroad company in acquiring the stock in the coal companies was to secure to itself a supply of coal to be used as fuel in running its trains, and the purpose in acquiring the stock in the elevator company was to facilitate the handling and shipping of grain to be carried over its road; also, the statements that the railroad company does not operate or control the operation of either of those coal companies or the elevator company, but, on the contrary, each is controlled and operated by its own board of directors and officers appointed by the board, and that each company is performing the duties required by its charter and serving the public

impartially as the law requires. Those statements must be taken as true with only this qualification, to wit: The law presumes that the railroad company has exerted its power as a stockholder in electing the directors, and to that extent influences the policy of each company.

Under the state of facts above mentioned, the only question of law in this case is, May a railroad company own the majority of stock in a coal company adjoining or near its line of road or in an elevator company offering a convenient means to aid it in the handling and shipping of grain? The question is not can a railroad company be held to account in a proceeding in quo warranto for an abuse of the power which the ownership of a majority of such stock gives, for perhaps no one would doubt that it would be amenable to such an inquiry, but where there has been no abuse of power, where the business of the corporation is being conducted in the usual way of such business concerns, is it unlawful for the railroad company to own the stock?

The only written law to which we are referred as sustaining the contention that it is unlawful for a railroad company to own stock under such conditions is section 7 of article 12 of the Constitution, in which is the following: "No corporation shall engage in business other than that expressly authorized in its charter or the law under which it may have been or hereafter may be organized." That clause in the Constitution does not refer to the ownership of stock in another company. The thing forbidden is the engaging in business not authorized by its charter. It would doubtless be a violation of that clause of the Constitution if a railroad corporation should acquire and use the stock of another corporation in whose business a railroad company could not lawfully engage as a cover behind which to carry on such business—that is, as a mere means of evading the letter of the law—still in such case the offense would be the carrying on of the business, not the owning of the stock. It would perhaps not be contended that a railroad company could not lawfully own a coal mine and operate it if necessary for the sole purpose of obtaining fuel for its own use, or that it could not own and operate an elevator in the handling of grain to be transported over its railroad. The business therefore of mining coal or operating an elevator is not business of such a character as the clause in the Constitution above quoted forbids. If the railroad company could do that business with its own means, why could it not secure itself in the matter of obtaining coal for fuel or a convenience in handling grain by acquiring stock in a coal or elevator company, if it would be more convenient, and if the public was not injured thereby? The more stock a corporation owns in another concern the more power it has in the election of directors, and through them in influencing the policy of the other corporation, but that is not in fact taking the management of the business in its own hands.

We are not overlooking the fact that, where a corporation owns practically all the stock in another concern, it may, if so minded, dictate through the board of directors the method of the business, which would



be equivalent to indirectly conducting the business; but that consequence does not necessarily follow. The directors may be chosen with an eye to their ability and honesty, and left to conduct the business according to their best judgment, and the law will presume that such is the case until the contrary is shown. If it should be shown that directors are conducting the business in the interest alone of a stockholder who elected them and to the injury of the other stockholders or to that of the public in general, a case of fraudulent mismanagement would appear, calling for the arm of a court of equity; but such is not this case. We therefore conclude that section 7 of article 12 of the Constitution does not forbid a railroad company to own stock in a coal company or an elevator company, and we hold that the mere fact that the railroad company does own a majority or all but a few shares of the stock in those companies does not authorize a judgment of dissolution of the corporations and ouster of their franchises.

It is charged in the information that the charters of the coal companies and the elevator company have become a mere cover for the railroad company under which to hide its unlawful usurpation of the corporate franchises, that those companies by such unlawful usurpation by the railroad company have been rendered incapable of conducting their business, and that their businesses are being conducted by the railroad company. But those statements are denied in the answer of respondents. It is there stated that the business of each of those companies is and has been from the beginning conducted under the direction and control of its own board of directors. Those statements are to be taken as true, and, taking them as true, it leaves the state's case nothing to rest on but the bare fact that the railroad company owns the majority of stock in those other companies.

There is no use for us to go further, and decide whether or not a railroad company may lawfully acquire and hold any or all the capital stock of another corporation whose business has no influence in aiding it in operating its railroad, because there is no such question before us. The court will take judicial knowledge of the fact that coal for fuel is a necessity in the operation of a steam railroad, and that an elevator, although not an absolute necessity, is an assistance in the handling and shipping of grain, and we hold that a railroad company may acquire stock in coal and elevator companies when the purpose is, as in this case it is, to facilitate the business for which it was chartered.

Our judgment is that the ouster demanded in the information should be denied and the respondents discharged. It is so ordered. All concur, except KENNISH, J., not sitting, having been of counsel.

VII. Power of Corporation to Acquire and Hold Its Own Stock <sup>s</sup>

## In re FECHHEIMER FISHEL CO.

(United States Circuit Court of Appeals, Second Circuit, 1914. 212 Fed. 357, 129 C. C. A. 33.)

Appeal from the District Court of the United States for the Southern District of New York.

In the matter of the Fechheimer Fishel Company, bankrupt. From an order confirming an order of the referee postponing the payment of any dividend upon the claim of the estate of Bernard Rothenberg, deceased, until after the claims of general creditors had been paid in full, Albert Dellevie, as sole surviving executor, appeals. Affirmed.

The Fechheimer Fishel Company is a corporation organized under the laws of the state of New York and doing business in the city of New York. Its capital stock was fixed at \$550,000, divided into 5,500 shares of the par value of \$100 per share, and of this amount all but \$20,000 was issued. In addition debenture bonds aggregating \$550,000 were authorized, all of which were issued except \$20,000 retained in the treasury of the corporation for future use. The bonds and stocks were issued to the organizers of the corporation, each of whom held, dollar for dollar, equal amounts of bonds and of stock.

By agreement, made part of the bonds, it was provided that "bonds" and stock should be inseparable and that on any sale of "bonds" an equal amount of stock should go with them. The right to sell or dispose of the bonds and stock held by any member of the corporation was limited to a sale to the other members in the manner provided by the agreement, and it was required that on the retirement of any member, for any reason, his bonds and stock should be sold to the other members at the book value of the bonds or else that the corporation should be dissolved and liquidated.

On November 1, 1909, Bernard Rothenberg was the holder of a "bond" of the Fechheimer Fishel Company for \$50,000 and a like amount of its stock and was also treasurer of the company. On that date he indorsed in blank and delivered to the company the "bond" and the certificate for the stock and received from the company a note for \$50,000, dated November 1, 1909, payable two years after date, with interest at 6 per cent. per annum, payable semiannually. He also received an agreement by the company to pay him an additional 2 per cent. per annum so as to make the interest on the note equal to the interest on the bond. This agreement was not actually dated or deliver-

<sup>s</sup> For discussion of principles, see Clark on Corp. (3d Ed.) §§ 56, 57.

ed until January, 1910, but was apparently part of the same transaction in which the note was given. This note was entered by Rothenberg himself in the company's bills payable book, but on the last page, and not where such an entry would naturally appear. The bond and stock were put, in an envelope marked with Rothenberg's name, in the company's safe. The bond was never canceled in the manner customary when bonds were surrendered. On August 9, 1911, this note was renewed by a new note for the same amount, payable November 1, 1912, accompanied by a similar agreement for the payment of additional interest. This is the note on which the claim is made. The Fechheimer Fishel Company was adjudicated bankrupt.

It was contended by the trustees in bankruptcy and held by the referee and by the court below:

First, that the so-called "bonds" were in reality merely a form of preferred stock and as such subject to the general rules of law applicable to a corporation's purchase of its own stock.

Second, that the corporation had no right to buy its own stock unless it was possessed of net profits sufficient to pay therefor without diminishing the fund upon which creditors had a right to rely.

Third, that the claimant was bound by the terms of the "bond" or stock and could not receive any payment in advance of general creditors.

Before LACOMBE, WARD, and ROGERS, Circuit Judges.

ROGERS, Circuit Judge (after stating the facts as above). It is necessary in the first place to determine the real nature of the so-called "debenture bonds" which this corporation issued. The courts have determined that the fact that an instrument is called a "bond" is not conclusive as to its character. It is necessary to disregard nomenclature and look to the substance of the thing itself. The distinguishing feature of a bond is that it is an obligation to pay a fixed sum of money with stated interest. The distinguishing feature of stock is that it confers upon its holder a part ownership of the assets of the corporation and gives him a right to participate in the management of the corporation and to share in the surplus profits and on dissolution to share in the assets which remain after the debts are paid.

The "debenture bonds" involved in this case provide on their face as follows: "This bond is issued subject to and with the benefit of the terms and conditions endorsed thereon, which are deemed part of it." Among the conditions so indorsed on the bonds was the following: "All the bonds of said series A are to be subordinate to the claims of the general business creditors of said company, and upon liquidation or dissolution of said company or upon the final distribution of its assets, such creditors shall be entitled to priority of payment in full over said bonds."

Another condition indorsed on the bonds provides that the said debenture bond shall be entitled to receive out of the earnings interest at the rate of 8 per cent. per annum before any dividend shall be set



apart or paid on the stock of the company, and that such interest shall be cumulative. It is also provided that, upon the liquidation or dissolution of the company's business or the final distribution of its assets, the said debenture bonds shall after payment of the debts of the company be entitled to the whole residue of the company's assets. All these features are quite characteristic of stock. They are not at all characteristic of bonds. And we are satisfied that no error was committed by the court below in holding that these so-called "bonds" were in effect preferred stock. *Burt v. Rattle*, 31 Ohio St. 116; *Hilson Co. v. State Board of Assessors*, 82 N. J. Law, 2, 80 Atl. 929; *Cass v. Realty Securities Co.*, 148 App. Div. 96, 132 N. Y. Supp. 1074, affirmed 206 N. Y. 649, 99 N. E. 1105.

The bond for \$50,000 which Rothenberg surrendered to the company on November 1, 1909, being in effect preferred stock of the company, the transaction was therefore a purchase by the company of its own stock and payment therefor by the issue of its own note, which, after renewal, matured when the company was insolvent. We are thus led to inquire whether the company had the right to purchase the stock and, if so, under what conditions.

The courts are not at all agreed concerning the right of a corporation to purchase its own stock.

The view that a corporation cannot buy its own stock without an express grant is based on the following grounds:

1. That corporations cannot increase or diminish their capital stock without the sanction of the Legislature.
2. That such a transaction is a fraud upon creditors.
3. That it is foreign to the purposes for which the corporation was created.

In England the courts, in a long and unbroken line of decisions, have held that a corporation, unless expressly authorized to do so, cannot purchase its own stock. The leading case in that country upon the subject was decided in the House of Lords in 1887, *Trevor v. Whitworth*, L. R. 12 App. Cas. 409.

In the United States the courts of some of the states have followed the English rule. But the clear weight of authority upholds the right of a corporation to buy its own stock if the purchase is made in good faith and does not prejudice the rights of creditors. *Cook on Corporations*, vol. 1 (7th Ed.) § 311.

The text-writers have arrayed themselves generally on the side of the English rule. *Thompson on Corporations* says, in volume 2, § 2054: "The rule which forbids a corporation thus to employ its funds rises to the grade of a rule of public policy; and is so strong that although power is conferred upon the company to deal in the shares of joint-stock companies generally, this does not authorize it to deal in its own shares."

*Machen on Modern Law of Corporations* says, in volume 1, § 628: "In America, many courts uphold the same sound and wholesome doc-

trine as the English cases. But it must be conceded that a somewhat larger number of the American courts have taken the view that a corporation may without express statutory authority purchase its own shares, provided the purchase is entered into bona fide and does not endanger the claims of creditors. It should be observed that the American cases which agree with the English doctrine are often well considered and fully reasoned, whereas those which uphold the contrary view generally lack any extended examination of the subject."

Mr. Morawetz, in his work, says in volume 1, § 112: "No verbiage can disguise the fact that a purchase by a corporation of shares in itself really amounts to a reduction of the company's assets, and that the shares purchased do in fact remain extinguished, at least until the reissue has taken place. The fact that such a transaction may not necessarily be injurious to any person is not a sufficient reason for supporting it. It is contrary to the fundamental agreement of the shareholders, and is condemned by the plainest dictates of sound policy. To allow the directors to exercise such a power would be a frightful source of unfairness, mismanagement, and corruption. It is for these reasons that a shareholder cannot be allowed to withdraw from a corporation with his proportionate amount of capital, either by a release and cancellation before the shares have been paid up, or by a purchase of the shares with the company's funds."

We have referred to the opinions of these writers because we think that, in recognizing the right of a corporation to buy its own stock, they indicate the necessity of confining the right to purchase within strict limits. Indeed, the dangers incident to the recognition of the right has led the Legislatures in a number of the states to prohibit the right altogether. And Congress in enacting the law relating to national banks has denied to such banks any right to purchase their own stock.

The corporation which purchased its stock in the case at bar was organized under the laws of New York, was engaged in business in New York, and entered into the purchase of the stock in New York. And under the law of New York a corporation has the right to purchase its own stock. *City Bank of Columbus v. Bruce*, 17 N. Y. 507 (1858); *Vail v. Hamilton*, 85 N. Y. 453, 457 (1881); *Joseph v. Raff*, 82 App. Div. 47, 54, 81 N. Y. Supp. 546, affirmed 176 N. Y. 611, 68 N. E. 1118. But the purchase must be made out of surplus profits and cannot be made from the capital. The Penal Law of the state provides, in section 664, that: "A director of a stock corporation, who concurs in any vote or act of the directors of such corporation, or any of them, by which it is intended: \* \* \* (5) To apply any portion of the funds of such corporation, except surplus profits, directly or indirectly, to the purchase of shares of its own stock—is guilty of a misdemeanor."

In *Richards v. Wiener Co.*, 207 N. Y. 59, 65, 100 N. E. 592, 593 (1912), the Court of Appeals, in speaking of an agreement by the cor-

poration to purchase its own stock, said: "The contract itself, therefore, was perfectly legal subject to certain limitations upon its enforceability. If when the time came defendant had a sufficient surplus, the contract would be enforced. If it had not, the contract could not be enforced."

But the contract in that case involved an agreement by the corporation to purchase its stock on a certain contingency. The agreement was made with one who had bought his stock on the corporation's promise to employ him in its business, with the right reserved to discontinue his employment at its option, and, in case of a discontinuance, the corporation bound itself to repurchase his stock if he so desired. What the court held was that the agreement was not invalid, but that its enforceability depended upon whether "when the time came" it had a sufficient surplus. In that case the time for the payment for the stock would be concurrent with the seller's exercise of his option to sell. But this is not decisive of the case at bar. In the case before us the time for the payment of the stock was not concurrent with the purchase but was postponed for two years and then again postponed for an additional year. Assuming that the corporation was solvent when the stock was purchased and that the contract was therefore valid at that time, the question we have to decide is as to the effect of the subsequent insolvency of the corporation upon this obligation of the company to pay for the stock. We are not aware that the New York courts have dealt with that question, and we must decide it upon principle with the aid of such light as the decided cases throw upon it.

The courts have decided in numerous cases that a corporation cannot buy its own stock if at the time it is insolvent. *Tiger Bros. v. Rogers, etc., Co.*, 96 Ark. 1, 130 S. W. 585, 30 L. R. A. (N. S.) 694, Ann. Cas. 1912B, 488 (1910); *Currier v. Lebanon Slate Co.*, 56 N. H. 262 (1875); *Alexander v. Relfe*, 74 Mo. 495 (1881); *Hall & Farley v. Alabama, etc., Co.*, 173 Ala. 398, 56 South. 235 (1911).

There is no evidence in this case that, at the time the agreement was made to buy Rothenberg's stock, the company was insolvent. But we are not by any means to understand that a corporation has a right to buy its own stock simply because it is solvent at the time, because if it becomes insolvent thereafter and before payment has been made, or if it is made insolvent by the transaction, the payment cannot be made, for the Penal Law of the state makes it a crime to apply anything but "surplus profits" to the purchase of the stock, and there are no such profits which can be applied.

In *Fitzpatrick v. McGregor* (1909) 133 Ga. 332, 340, 65 S. E. 859, 862 (25 L. R. A. [N. S.] 50), the court declares that the creditors of the corporation can question the purchase "when the circumstances are such as to show that the transaction was fraudulent in fact, or that the corporation was insolvent, or in process or contemplation of dissolution at the time the purchase or exchange was made, and



also that the transaction diminished their (the creditors') security for the debts due them."

The courts also recognize the right of a corporation to take its own stock in payment of a security for antecedent debts when it is necessary to do so. Cook on Corporations (7th Ed.) § 892.

But there is no evidence in this case that Rothenberg was indebted to the company at the time this purchase of the stock took place, or that he was insolvent at that time or at any other time, or that the stock was taken in payment of an antecedent debt. On the contrary, in the case at bar the corporation bought the stock outright and gave its note in payment therefor.

The note for \$50,000 due November 1, 1912, which is the basis of the claim involved in this case is a renewal of a note for the same amount given by the bankrupt on November 1, 1909. Whatever infirmity inhered in the original note attached to the renewal note. *Hamor v. Taylor-Rice Engineering Co.* (C. C.) 84 Fed. 392, 398 (1897). As the note was given by the corporation for its own stock, the right to enforce payment out of the assets of the corporation depends upon the existence of surplus profits.

If at the time the stockholder receives payment for his stock the payment prejudices the creditors, payment cannot be enforced. If a stockholder sells his stock to a corporation which issued it, he sells at his peril and assumes the risk of the consummation of the transaction without encroachment upon the funds which belong to the corporation in trust for the payment of its creditors.

The right of the creditors of the corporation cannot be defeated by the fact that at the time the transaction was entered into the seller of the stock and the officers of the company who purchased it were acting in good faith and supposed that the company was solvent.

The Supreme Court of Illinois in *Commercial National Bank v. Burch*, 141 Ill. 519, 31 N. E. 420, 33 Am. St. Rep. 331, said: "Purchase of its own stock by a corporation by the exchange of its property of equal value, though made in good faith and without any element of fraud," or "anything in the apparent condition of the" corporation "to interfere with the making of the exchange, will not be allowed where it injuriously affects a creditor of the" corporation, "even though the fact of the indebtedness was not at the time established or known to the stockholders. \* \* \* The capital stock of" a corporation "is a fund set apart for the payment of its debts, and the directors \* \* \* hold it in trust for that purpose. \* \* \* The shareholders of the corporation are conclusively charged with notice of the trust character which attaches to its capital stock. As to it they cannot occupy the status of innocent purchasers," and, when "they have in their hands any of the trust fund, they hold it cum onere, subject to all equities which attach to it."

In *Clapp v. Peterson*, 104 Ill. 26 (1882), the same court, after stating that the shareholders of a corporation are conclusively charged

with notice of the trust character which attaches to its capital stock and that when they have any of this trust fund in their hands they hold it cum onere, subject to all the equities which attach to it, went on to say: "It is objected, against the principles above stated, that the cases in which they were declared were where there was actual or constructive fraud or unfairness, where the corporations were insolvent, or in process of being wound up. The question naturally would arise mostly in such circumstances, but the principles enunciated are general in scope, following from the nature of the capital stock of corporations, and the relation of a stockholder to the corporation, and we know of no limitation of their application as above suggested." In this statement we fully concur. There can be no such limitation of the principle.

The Supreme Court of Connecticut, in *Crandall v. Lincoln*, 52 Conn. 73, 52 Am. Rep. 560 (1884) said: "If the view we have taken of the character and nature of this stock is sound," that it is a trust fund for the security of creditors, "and we have no doubt that it is, the conclusion inevitably follows that under no circumstances can a stockholder sell his stock to the company and take therefor his portion of the capital stock to the prejudice of creditors. The illegality of the transaction does not at all depend upon the actual knowledge or mala fides of the seller; if he in fact sells to the company and receives in return a part of the capital, the policy of the law requires him to know it, and conclusively charges him with knowledge. Thus selling, he sells at his peril. In no other way can the rights of creditors be protected. The seller can protect himself by selling to other parties, or he may hold his stock, taking, as he is bound to, the risk of his investment. The creditor is not bound to assume any part of the stockholder's risk, and he has no way of protecting himself. The law is his only protection."

The above cases were not based on any local statute, but upon general principles.

In saying that the assets of a corporation constitute a trust fund, we are to be understood as referring to the assets of an insolvent corporation. A solvent corporation, of course, holds its property as any individual holds his. But when a corporation becomes insolvent, a trust arises in respect to the administration of its assets for the benefit of its creditors. *Hollins v. Brierfield, etc., Co.*, 150 U. S. 371, 381, 383, 14 Sup. Ct. 127, 37 L. Ed. 1113 (1893); *McDonald v. Williams*, 174 U. S. 397, 401, 19 Sup. Ct. 743, 43 L. Ed. 1022 (1899). Hence when a corporation buys its own stock payment cannot be made with funds which upon insolvency belong to its creditors instead of to its stockholders. *Cook on Corporations* (7th Ed.) vol. 1, § 9, pp. 42, 43.

In *Clark v. E. C. Clark Machine Co.*, 151 Mich. 416, 115 N. W. 416 (1908), a corporation purchased some of its own stock for which it gave three promissory notes in payment secured by a chattel mort-

gage. The corporation at the time it made the purchase owed somewhere within \$300. The assets of the corporation were worth about \$9,000. The stockholders had all agreed to the purchase and, if there were any creditors existing at the time of the purchase, none of them complained. All the creditors who did complain were subsequent creditors who gave credit with the mortgage on file in the proper office, but who insisted that it was not notice to them that the assets of the company had been used to purchase some of the capital stock. The court said that the assets of a corporation constituted a trust fund not only for the benefit of existing but also for future creditors, and that they could not be used in the purchase of outstanding stock to the exclusion of subsequent creditors. It added: "It is apparent under the record as it now stands that the assets will be more than sufficient to pay the debts. Should this prove to be the case Mr. Wells (whose stock the company purchased) will be entitled to receive out of the surplus sufficient to pay this amount. The decree will be modified in accordance with this opinion."

In other words, the right of the vendor of the stock to receive payment on the notes given him by the corporation for his stock was not conclusively established by the fact that the corporation was solvent when the purchase was made. His right turned on the condition of the assets at the time payment was to be made and he could only be paid out of the surplus if any there should be.

The Supreme Court of Michigan, in 1906, in *McIntyre v. Bement's Sons*, 146 Mich. 74, 109 N. W. 45, 10 Ann. Cas. 143, held that an agreement by a corporation to take back its stock at cost at the expiration of two years if the purchaser so wished became void on the corporation's becoming insolvent at or before the purchaser sought to exercise his option. It was claimed in that case that, if the promise when given was valid, subsequent insolvency of the maker would not make it invalid. The court admitted that this would be true as respects the usual and ordinary contracts of corporations and individuals, but held that this principle did not apply to contracts made by a corporation for the purchase of its stock.

The stock of a corporation is its only basis of credit, and it is of vital importance that it be rigidly guarded and protected. Courts have conceived it to be their duty to detect and defeat any scheme or device calculated in any way to place this fund beyond the reach of the creditors. *Buck, Trustee, v. Ross*, 68 Conn. 29, 31, 35 Atl. 763, 57 Am. St. Rep. 60 (1896). As the illegality of a purchase by a corporation of its stock rests upon the fact that it withdraws assets upon which the creditors have a superior right or lien, it seems to us that even though the company may have been solvent when the contract to purchase was made, if it becomes insolvent later or is made insolvent by the transaction and is in that condition at the time when payment is to be made, the vendor cannot as against creditors be permitted to take the assets for that purpose in a state in which the stat-



utes make it a criminal offense to apply directly or indirectly anything but surplus profits to the purchase by a corporation of its own stock. If the stockholder postpones the time of payment, he runs the risk of the corporation becoming insolvent in the meantime and must be held to a knowledge of the fact that he cannot enforce payment if in doing so he deprives the creditors of assets upon which they have a lien superior to any claim of his. In the case at bar, when the corporation bought the stock and gave its note to Rothenberg, it in effect promised to pay him \$50,000 out of surplus profits and if payment could be made without prejudice to creditors. To be sure the note did not so state on its face, but that was a condition which the law attached to it and which was binding on both Rothenberg and the company. The fact that the corporation had a surplus when the note was given is not decisive of the case if it was insolvent when the time for payment arrived. What the rule may be in the absence of such a statutory provision as exists in New York we need not now determine.

The bond was a promise to pay Rothenberg "and any subsequent registered holder" \$50,000 on November 1, 1904. Payment was thereafter extended to November 1, 1910. Before that time arrived and on November 1, 1909, Rothenberg surrendered the bond and accepted a note for \$50,000, and it was agreed that he should have the same interest on the note that he was to receive on the bond. That note was payable in two years, but before the time for payment came a new note was given, dated August 25, 1911, payable November 1, 1912, which was similar in amount to the bond both as to principal and interest. Assuming that the bond was nothing more than preferred stock, it is necessary to consider whether the fact that it had a definite due date affords any sufficient reason for distinguishing it from stock not so limited in time, and making it necessary to hold that all who became creditors after the due date, or after the date of the first note or the date of the renewal note should be held to have no claim superior to Rothenberg's upon the assets of the corporation. We do not think that under the facts of this case we can make any such distinction. The manner in which this corporation sought to conduct its business was extraordinary and altogether unusual. The trustees charge that the arrangement by which the bond was surrendered and the note issued in lieu thereof was devised and executed for the purpose of evading and defeating the provision of the bond which recited that it was to be "subordinate to the claims of the general business creditors of said company, and upon liquidation or dissolution of said company, or upon the final distribution of its assets, such creditors shall be entitled to priority of payment in full over said bonds." Whatever may have been the reasons which influenced Rothenberg and the company in their dealings with each other, we are satisfied that, if we should construe the note as counsel for Rothenberg ask us to construe it, the effect certainly would be to prejudice the rights of the creditors, in disregard of the New York statute. The surrender

of the bond which the company seems never to have canceled and the giving of the note did not in itself work any reduction in the amount of the capital for neither were ever paid, and the \$50,000 remained in the business being at no time withdrawn. The due date of the bond and the due date of the note are alike immaterial under the circumstances of the case. At the best they only indicated a time when a reduction of the capital stock might have been made under the agreement, but, as the reduction was not made, it may be disregarded. There is a well-established principle to the effect that if an individual, even without any intention to defraud creditors, disposes of his property without consideration, those who subsequently become creditors cannot complain or ask to have the transfer set aside, so that they can reach the property and apply it to the payment of their debts. The reason is they have not been injured or prejudiced in their rights as they gave credit to the debtor in the condition he was in after the transfer was made. The courts have applied the same principle to the creditors of corporations. *Graham v. La Crosse & Milwaukee R. Co.*, 102 U. S. 148, 26 L. Ed. 106. In the case at bar no part of the capital had been withdrawn and paid over to Rothenberg and the creditors gave credit to the corporation on the strength of its unreduced capital. And if, at any time after any one of these creditors gave credit on the strength of its capital, any part of that capital as distinguished from its surplus had been paid over to Rothenberg, such creditor might have maintained a suit in equity against him to recover from him and subject to the payment of his claim any part of the capital which Rothenberg so received. *Guinness v. Land Corporation of Ireland*, 22 Ch. Div. 349, 375 (1882); *Wood v. Dummer*, 3 Mason, 308, Fed. Cas. No. 17,944 (1824); *Buck v. Ross*, 68 Conn. 29, 35 Atl. 763, 57 Am. St. Rep. 60 (1896); *Bartlett v. Drew*, 57 N. Y. 587 (1874); *Singer v. Hutchinson*, 183 Ill. 606, 56 N. E. 388, 75 Am. St. Rep. 133 (1900).

The court below in its decision stated that "the bankrupt corporation was really a copartnership masquerading as a corporation." The court added: "Reduced to its lowest terms, what Rothenberg did was to convert his partnership interest into a debt of the concern, without liquidation. If he can do this, all other bondholders could have done the same thing. So that, if this claim is good, every debenture might have been converted into a note; the consideration being in each case forbearance from enforced liquidation. This seems to me *reductio ad absurdum*."

In confirming the order which the court below made, we disclaim any intention of treating this corporation as a partnership. The provision by which the incorporators agreed that their right to sell their stocks and bonds should be limited to a sale to the other members of the corporation and that, if they did not wish to purchase, then the corporation should be dissolved and liquidated, did not destroy its character as a corporation.

If this corporation is not a corporation in law but is to be regarded as a partnership, there can be no reason, of course, why the other partners could not have bought out Rothenberg's interest. In that event the purchase of his interest would work a dissolution and a winding up of the partnership; in which case the creditors would be paid before the partners.

But it was as we have said, not a partnership, and it is not to be treated as one. There is no real analogy between a partnership and a corporation, as is clearly pointed out in a case decided in the House of Lords. *Birch v. Cropper*, L. R. 14 App. Cas. 525.

The order of the referee was confirmed by the court below, and it postponed the payment of dividends out of the bankrupt's estate on the claim of Rothenberg's executor for the sum of \$50,925 until after the claims of general creditors of the bankrupt have been paid in full.

The order of the court below is affirmed.<sup>9</sup>

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## VIII. Form and Mode of Corporate Contracts<sup>10</sup>

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### UNITED SURETY CO. v. MEENAN.

(Court of Appeals of New York, 1914. 211 N. Y. 39, 105 N. E. 106.)

Appeal from Supreme Court, Appellate Division, First Department. Action by the United Surety Company against Daniel Meenan. From a judgment of the Appellate Division (151 App. Div. 942, 136 N. Y. Supp. 1149), affirming a judgment for plaintiff, defendant appeals. Reversed.

June 17, 1909, the Gore-Meenan Company, of which Frank E. Gore was president, and the defendant Daniel Meenan was secretary, together with the respondent, executed a bond to Benjamin B. Odell, Jr., and William E. Paine, as receivers of the Thomas McNally Company, in the sum of \$100,000, which recited that the Gore-Meenan Company had entered into a contract with said receivers, bearing date the 15th day of June, 1909, whereby said company had been employed by said receivers to construct part of the Catskill aqueduct between Garrison and Peekskill, as shown on the contract drawing for contract No. 2 between the McNally Company and the city of New York. The condition of the obligation was that the Gore-Meenan Company should faithfully perform the contract and pay bills for labor performed and materials furnished. This bond was executed by the Gore-Meenan Company by Gore as president. The first premium for six months of

<sup>9</sup> See article, "Power of a Corporation to Acquire Its Own Stock," by I. Maurice Wormser, in *Yale Law Journal* for January, 1915, Vol. 24, p. 177.

<sup>10</sup> For discussion of principles, see Clark on Corp. (3d Ed.) §§ 58-61.



1909 and six months of 1910, to wit, for one year, was paid by a check made by the Gore-Meenan Company to the order of the plaintiff for \$2,500, dated June 21, 1909.

It appears by the record that on the 22d day of June, 1909, five days subsequent to the bond spoken of above, an application was made by the Gore-Meenan Company to the United Surety Company for a bond on behalf of the Gore-Meenan Company to be executed by Frank E. Gore and Daniel Meenan, as officers of said company; the amount of said bond was to be \$100,000, and the nature of the contract was the same as that referred to in the bond above mentioned. Attached to said application was a statement of the assets and liabilities of the Gore-Meenan Company, which disclosed assets of \$191,010, and liabilities, exclusive of capital stock, of \$8,750. The application contained a covenant to pay \$2,500 per annum in advance to the plaintiff for executing said bond, and with a requirement that the Gore-Meenan Company would indemnify and save harmless the United Surety Company by reason thereof. This application was executed in the name of the Gore-Meenan Company by Frank E. Gore, president.

June 23, 1909, the day following the application referred to, the instrument in suit was executed, which upon its face recites that the undersigned have requested the surety company to execute a bond or undertaking in the sum of \$100,000 in behalf of the Gore-Meenan Company and in favor of the receivers for the construction of the work hereinbefore mentioned, an agreement to pay the premium of \$2,500 annually on the 17th day of June of each year, and to indemnify and keep indemnified the surety company against any and all demands and liabilities, etc.

The instrument also contains the language: "That this agreement shall bind, not only the undersigned jointly and severally, but also our respective heirs, executors, administrators, successors and assigns (as the case may be) until the company shall have executed a release under its corporate seal, attested by the signature of its officers proper for the purpose." Following the date of the instrument it is signed "Daniel Meenan," the signature extending over the word "Seal," "P. O. Address 35 West 88 St., City," and "Frank E. Gore [Seal], P. O. Address 795 St. Nicholas Ave., City," and also the imprint of a seal, bearing upon its face "Gore-Meenan Co. New York," and in the center thereof "Incorporated 1907." Then follows the following acknowledgments before Philip O. Bischoff, notary public:

"State of New York, County of New York—ss.:

"On this 23 day of June, 1909, before me personally came Frank E. Gore, president of the Gore-Meenan Co., to me personally known and known to me to be the individual described in and who executed the foregoing agreement and he acknowledged that he executed the same. Philip O. Bischoff, Notary Public No. 82 Kings Co., N. Y. Registered N. Y. County.

"State of New York, County of New York—ss.:

"On the 23 day of June in the year 1909, before me personally came Daniel Meenan; to me known, who being by me duly sworn, did depose and say: That he resides in 35 West 88 St. N. Y. City; that he is the secretary of the ——— the corporation described in and which executed the foregoing instrument; that he knows the seal of said corporation; that the seal affixed to the said instrument is such corporate seal; that it was so affixed by order of the board of directors of the said corporation and that he signed his name to the said instrument by like order. Philip O. Bischoff, Notary Public No. 82 Kings Co., N. Y. Registered N. Y. County."

This action was brought against Meenan and Gore individually, though Gore was not served in the action, to recover the sum of \$2,500, with interest from the 17th day of June, 1910, being the premium for one year from that date. The defendant Meenan answered, denying that he had executed such bond. At the close of the case judgment was directed for plaintiff against Meenan, and upon appeal therefrom the judgment was affirmed by the Appellate Division.

HOGAN, J. The sole question to be determined on this appeal is the correctness of the rulings made by the trial justice in the exclusion of evidence offered on behalf of defendant to avoid liability upon the instrument in suit and to establish that the writing in question was the undertaking of the Gore-Meenan Company, of which defendant was secretary, and was not the individual obligation of the defendant; that the plaintiff obligee in the bond understood that the instrument in suit was the undertaking of the corporation, not only from the face of the same, but it had treated it as such by subsequently preparing an indemnity bond and seeking to have Meenan individually execute the same in lieu of the bond in suit. For the purpose of establishing the acts and knowledge of plaintiff, defendant called as a witness a representative of the plaintiff and propounded questions to him tending to disclose knowledge on the part of the plaintiff that the bond was intended by plaintiff to be the bond of the Gore-Meenan Company, that it had been treated as such by the plaintiff, and that an attempt had been made by plaintiff after the execution of the instrument in question to secure from defendant individual indemnity in addition to the Gore-Meenan liability. All parol evidence offered by defendant along the line stated was excluded over exceptions by defendant.

If upon the face of the instrument in suit such ambiguity is found as to be consistent with the construction either that the defendant intended to execute the same on behalf of the Gore-Meenan Company or as an individual, parol evidence was admissible to prove the circumstances under which the bond was executed and the character in which the defendant signed the same.

The bond in its entirety, including the acknowledgment of the same, was set forth in the complaint in the action, and was received in evi-

dence upon the trial. It was prepared by the plaintiff and under well-established rules of law must be strictly construed against it. The body of the bond does not contain the name of the defendant. True it does refer to the parties thereto in an individual sense, but it also refers to "successors," thus disclosing the adaptability of the blank form to execution by a corporation as well as by an individual. At the close of the instrument will be found first the corporate seal of the Gore-Meenan Company; this was followed by the signature of the defendant Meenan and the signature of Gore. The acknowledgment was by Gore, "President of the Gore-Meenan Co."; then follows the acknowledgment wherein appears the name of Meenan who did depose that he was secretary of the Gore-Meenan Company, "the corporation described in and which executed the foregoing instrument; that he knows the seal of the said corporation; that the seal affixed to the said instrument is such corporate seal; that it was so affixed by order of the board of directors of the said corporation and that he signed his name to the said instrument by like order."

The instrument upon the face thereof discloses it was executed the day following the execution by the Gore-Meenan Company of an application (which was placed in evidence by the plaintiff) for a bond substantially in terms the language of the bond in suit.

At common law a contract under the seal of a corporation, attested by the signature of its executive officers, was *prima facie* the contract of the corporation. The seal of the corporation was its signature. *Trustees v. McKechnie*, 90 N. Y. 618; *People's Bank v. St. Anthony's R. C. Church*, 109 N. Y. 512-525, 17 N. E. 408; *Quackenboss v. G. & R. F. Ins. Co.*, 177 N. Y. 71, 69 N. E. 223. The seal of the corporation having been affixed to the instrument, followed by the signatures of the president and secretary, designated in the acknowledgment as such, the presumption follows that the seal of the corporation was attached to the instrument by proper authority.

We are of the opinion that the instrument in suit was not free from ambiguity, and that parol evidence was admissible to prove the circumstances under which the same was executed, also to establish facts disclosing knowledge of the plaintiff that the purpose of the bond in suit was to bind the Gore-Meenan Company, and not the defendant in this suit (*Schmittler v. Simon*, 114 N. Y. 176, 21 N. E. 162, 11 Am. St. Rep. 621); therefore the trial justice was in error in refusing to receive such evidence, and for that reason the judgment must be reversed.

The judgment should be reversed and a new trial ordered; costs to abide the event.

WILLARD BARTLETT, C. J., and WERNER, COLLIN, and CUDDEBACK, JJ., concur. HISCOCK, J., dissents. MILLER, J., not sitting.



IX. Ultra Vires Conveyances of Land or Transfers of Personality<sup>11</sup>

## LEAZURE v. HILLEGAS.

(Supreme Court of Pennsylvania, 1821. 7 Serg. &amp; R. [Penna.], 313.)

TILGHMAN, C. J.<sup>12</sup> \* \* \* But the great points in this cause are, the capacity of the bank to take the land conveyed by William Henry's deed, and afterwards to convey the same to James Ross. There is no doubt that a corporation must be governed by the charter, from which it derives its existence. It can do no act nor take any estate contrary to its charter. If therefore it can be shown, that the Bank of North America, is forbidden by its charter, either to take, or to convey, the land contained in William Henry's deed, the plaintiff's action cannot be supported. By the 3d section of the Act of Incorporation, (17th of March, 1787, 2 Sm. L. 399,) the bank is made capable "to have, hold, purchase, receive, possess, enjoy, and retain, lands, rents, tenements, goods, chattels, and effects of whatsoever kind, nature or quality, to the amount of two millions of dollars and no more, and also to sell, grant, &c. the same lands, &c. Provided nevertheless, that such lands and tenements, which the said corporation are hereby enabled to purchase and hold, shall only extend to such lot and lots of ground, and convenient buildings, and improvements thereon erected or to be erected which they may find necessary and proper for carrying on the business of the said bank, and shall actually occupy for that purpose, and to such lands and tenements which are or may be bona fide mortgaged to them as securities for their debts." It is remarkable, that with regard to the holding of lands, the charter of this bank is more restricted than that of any other bank in the State, for all the others are enabled to hold, not only the lands which have been bona fide mortgaged to them by way of security for debts, but also those, "which may be conveyed to them in satisfaction of debts previously contracted in the course of their business, or purchased at sales upon judgments which shall have been obtained for such debts." This difference of restriction, must have arisen from the extreme jealousy of monied corporations which pervaded the mind of the Legislature when the Bank of North America was incorporated. It never could have been intended to place that bank on a worse footing than others, for it was the only one, which risked its capital on a field altogether untried in America, and which had the merit of rendering essential service to the United States, during the war of the revolution. It would be improper therefore, to carry the restriction, by construction, farther than the words

<sup>11</sup> For discussion of principles, see Clark on Corp. (3d Ed.) §§ 65, 66.<sup>12</sup> Opinion printed only in part.

of the law plainly import. The restriction is, that the bank shall not purchase and hold. Purchasing and holding, are very different things, and the consequences of each are very different. If the words had been, that the bank should neither purchase nor hold, then it could have done neither one nor the other. But although purchasing and holding might have been thought dangerous, because of the power which it would have given the bank to bring too much land into mortmain, yet to purchase, subject to the statutes of mortmain, which authorized the Commonwealth to appropriate the land to its own use, could be attended with no danger. This construction would satisfy the jealous policy of the Legislature, preserve the community from the danger of too great a mass of real property held in mortmain, and at the same time put it in the power of the Commonwealth to act towards the bank, as justice might seem to require. This is a consideration of no small importance; for when the directors of the bank accepted from William Henry, a conveyance of his land at a fair price, in payment of a debt bona fide due, it would be hard to presume, that they knew they were acting in violation of their charter.

But granting that the restriction in the charter, did not extend to the simple act of purchasing, it may be asked, whence did the corporation derive the right to purchase, and what would be the situation of land purchased, without a capacity of holding. The answer is, that a corporation has, from its nature, a right to purchase lands, though the charter contains no license to that purpose. And in this respect the statutes of mortmain have not altered the law, except in case of superstitious uses. But since those statutes, it is necessary, in order to enable a corporation to retain lands which it has purchased, to have a license for that purpose; otherwise in England, the next lord of the fee may enter within a year after the alienation, and if he do not, then the next immediate lord, from time to time, has half a year to enter, and for default of all the mesne lords, the king takes the land so aliened, for ever. That this is the law appears from the following authorities. 2 Black. Com. 268, 269. Co. lit. 2. 6 Vin. Ab. 265. (G. pl. 2.) id. 266. pl. 8. Jenk. Cent. 270. 3 Com. Dig. 399. (F. 10.) id. 401. (F. 15.) 1 Rol. Ab. 513. 1. 35. 10 Co. 30. But in Pennsylvania, where there are no mesne lords, the right would accrue immediately to the Commonwealth. It has been objected, however, that according to the report of the Judges of this Court, made on the 14th December, 1808, in pursuance of an Act of Assembly requiring them to make a report of the English statutes which are in force in the Commonwealth, &c., it appears, that all conveyances of land to a corporation, without license, are absolutely void. I will consider this objection. The Judges reported the following statutes of mortmain, "7 Ed. I. (Stat. 2.) 13 Ed. I. ch. 32. 15 Rich. II. ch. 5, and 23 Hen. VIII. ch. 10; which are in part inapplicable to this country, and in part applicable, and in force. They are so far in force, that all conveyances by deed or will, of lands, tenements, or hereditaments, made to a body corporate, are void, unless

sanctioned by charter or Act of Assembly. So also are all such conveyances void, made either to an individual, or to any number of persons associated, but not incorporated, if the said conveyances are for uses or purposes of a superstitious nature, and not calculated to promote objects of charity or utility." I have quoted the words of the report, and it is evident that the Judges could have no intent, nor had they power to make any addition to the statutes, or in any manner to alter them. Now by reference to the statutes, it will appear, that in all of them, except the 23 Hen. VIII. ch. 10; the conveyance is not absolutely void, but the estate passes to the corporation, subject as before mentioned, to the right of the several mesne lords, and in their default, of the king, to enter and hold in fee. But by the statute of 23 Hen. VIII. ch. 10, (which has been determined to extend to superstitious uses only, see 2 Black. Com. 273. 1 Co. Rep. 24,) uses and trusts, made and contrived in favour of religious persons, or any bodies corporate, for more than twenty years, shall be utterly void. Now the meaning of the report of the Judges is, that, according to the statute cited by them, conveyances to superstitious uses, are absolutely void, and conveyances to corporations, to uses not superstitious, are so far void, that those corporations shall have no capacity to hold the estates for their own benefit, but subject to the right of the Commonwealth, who may appropriate them to its own use at pleasure; in other words, that such conveyances have no validity for the purpose of enabling the corporation to hold in mortmain.

But to support the plaintiff's title, it must be shewn that the corporation had power, not only to take by purchase, but to alien. In this respect I consider a corporation in the situation of an alien, who has power to take, but not to hold. That an alien may take by purchase, (though not by descent,) has been settled from the earliest times. It is so laid down in Co. Lit. 2, and I believe has never been questioned. Neither has it been questioned, that the land is subject to forfeiture, and may be seised for the king, after office found. But it has been questioned, what is the right of the alien before office found for the king. Without reference to English cases, which leave the matter in doubt, we have the highest authority in our own country for saying, that until some Act done by the Commonwealth according to its own laws, to vest the estate in itself, it remains in the alien, who may convey it to a purchaser, but he can convey no estate which is not defeasible by the Commonwealth. This principle was asserted by Judge Story, who delivered the opinion of the Supreme Court of the United States, in the case of *Fairfax's Devisee v. Hunter's Lessee*, 7 Cranch, 603, 3 L. Ed. 453; and this was the opinion of the Supreme Court of Massachusetts, in the case of *Sheaffe v. O'Neil*, 1 Mass. 256, cited by Judge Story. It is reasonable in theory, and can have no ill effect in practice, that he who has a defeasible estate, may convey a defeasible estate. Provided the right of the Commonwealth to defeat the estate granted



by the alien remains entire, it is immaterial who holds the land until that right be prosecuted. Supposing then, that the cases of the alien, and the corporation be similar, (and I see not how they can be distinguished,) it follows that the deed, from the Bank of North America to James Ross, conveyed a fee simple, defeasible by the Commonwealth.

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### PRAIRIE SLOUGH FISHING & HUNTING CLUB v. KESSLER.

(Supreme Court of Missouri, 1913. 252 Mo. 424, 159 S. W. 1080.)

Appeal from Circuit Court, Lincoln County; J. D. Barnett, Judge.

Suit by the Prairie Slough Fishing & Hunting Club against William P. Kessler and wife. Decree for plaintiff. Defendants appeal. Reversed and remanded.

In this suit plaintiff, proceeding on the theory of a constructive trust, seeks to have a court of equity declare a trust in favor of plaintiff with reference to approximately 426 acres of land situated in Lincoln county, Mo., and by its decree to divest the title thereto out of defendants (the holders of the legal title), and vest the same in the plaintiff corporation, upon plaintiff's reimbursement to defendants of the amount paid by them for said land, and to compel defendants to account to plaintiff for the crops and rents received from said land.

The plaintiff is a corporation organized under the provisions of article 11, c. 12, R. S. 1899 (article 10, c. 33, R. S. 1909), by pro forma decree of the circuit court of the city of St. Louis, on December 4, 1900. A short time after the corporation was organized it acquired a ten-year lease on the land in controversy, whereby the company and its members were given the absolute and exclusive right and privilege to hunt and fish upon said land, and the right to erect a clubhouse, out-buildings, and fences upon a two-acre portion thereof. At this time the land in controversy was owned by Fred Naxera and Edward H. Knight. The clubhouse was erected, and the land leased was enjoyed by the corporation members as a place to hunt and fish. In 1906 defendant William P. Kessler was elected president of the plaintiff corporation, and served as such president until the latter part of 1908. During the time he was president of the club there was considerable discussion of the club's future among the members thereof, and of the propriety of procuring a renewal of the lease or purchasing the land outright. No formal action with reference to the matter was taken at any of the meetings of the board of directors, but some of the members testified that they discussed the matter with the president, William P. Kessler, and that he assured them he would look after the matter for the club and would try to get an option on the land for the club with a view to its purchase by the corporation. Later the said defendant procured an option from the landowners, taking the option in his own name and informed some of the members of the corporation that

he had procured an option for the "club." In October, 1907, defendant closed the deal for the purchase of the land, and had the owners of the land convey the same to himself and wife, his codefendant herein. The purchase price was \$6,500; defendants paying \$500 in cash, and executing their note, secured by deed of trust on the land, for \$6,000, due ten years after date, also separate notes for interest at 8 per cent. on said sum.

The testimony on the part of the plaintiff is that its members were not aware of this transaction until some time in July, 1908, when, at a meeting of the members of the corporation, Kessler submitted a proposition to the club, through its secretary, to the effect that he would sell the land to the club at a certain stipulated price, but that he would not renew the lease. A committee was appointed by plaintiff to investigate the matter, and upon investigation it was learned that the price asked was approximately \$6 an acre in excess of that paid by defendant for the property. A short time thereafter this suit was instituted, resulting in a decree for plaintiff as prayed.

Further facts necessary to a fuller understanding of the case are set forth in the interlocutory decree of the circuit court, which decree, omitting formal parts, is as follows:

"Now at this day, at the March adjourned term of the circuit court of Lincoln county, Mo., come again the parties to this suit, both plaintiff and defendants, by themselves and by their respective counsel, and all and singular the matters and things heretofore submitted to the court and taken under advisement, having been seen, heard, and considered, the court doth find: That the plaintiff, the Prairie Slough Fishing & Hunting Club, is a corporation organized under and by virtue of the provisions of article 11, c. 12, Revised Statutes of Missouri 1899. That the defendants, William P. Kessler and Lena Kessler, are husband and wife. That on the 1st day of August, 1900, a certain lease was executed by Fred Naxera and Edward H. Knight, and their respective wives, to one Adolph Vogler. That said lease covered the lands mentioned in plaintiff's petition, and described as follows: (Here follows description of said real estate). That said lease ran for a term of ten years, and until the 31st day of July, 1910, and that the yearly rental as fixed in said lease was the sum of \$50 per year. It is further found by the court: That under and by virtue of the terms of said lease it was provided that a frame building for residence and clubhouse purposes, outbuildings, and fences, should be erected on said premises by the lessee thereof, to cost at least \$1,000. That shortly after the execution of said lease said Vogler transferred and assigned all his right, title, and interest in said lease to the plaintiff, the Prairie Slough Fishing & Hunting Club, and that said Vogler, when he secured said lease from said Knight and Naxera, was acting for and on behalf of the plaintiff in securing said lease, and the same was taken for and on behalf of said club by said Vogler. The court further finds that the terms of said lease have in all respects been complied with by the plain-

tiff, and that the improvements have been erected by the plaintiff as provided for in the terms of said lease. The court further finds that the defendant, Wm. P. Kessler, on the ——— day of ———, 1906, was a member of the board of directors of said Prairie Slough Fishing & Hunting Club, and at said time was duly elected the president of said club, and was re-elected for the year 1907, and that he assumed the duties of said office as president, and occupied the said position during the years 1906 and 1907, and at all times mentioned in plaintiff's bill.

"The court further finds: That said plaintiff, through its members, and that various members of such corporation, for themselves as such members and for said club, as early as the fall of 1906, and at frequent times in the year 1907, informed said Kessler, while president of said club, that it was desirable on the part of plaintiff and its members to acquire the property mentioned and described in said lease and on which the said corporation had erected its clubhouse and other substantial improvements, costing more than the sum of \$1,000, and to purchase the same. That said Kessler, while acting as president, agreed with said members and promised them that he would purchase said property for the use and benefit of said club. That said defendant Wm. P. Kessler, while acting as president of said club, negotiated for the purchase of said property, from Knight and Naxera, the owners thereof, and that on the ——— day of ———, 1907, he procured the said Knight and Naxera, owners of said land, to execute to him and his wife, his codefendant, Lena Kessler, a warranty deed for all of said lands, at and for the price and sum of \$6,500. The court finds that the entire negotiations concerning the purchase of said lands were conducted by said Wm. P. Kessler alone; that said negotiations and the transfer of said property were kept secret from plaintiff and from the members of said organization; and that said Lena Kessler, wife of Wm. P. Kessler, contributed nothing toward the purchase of said property, but all moneys that were paid were paid out of the funds of Wm. P. Kessler alone. The court further finds: That Wm. P. Kessler paid to said Knight and Naxera the sum of \$500 in cash, and executed a note for the sum of \$6,000, dated October 18, 1907, payable in ten years after date, with interest thereon from its maturity at the rate of 8 per cent. per annum, and also 20 semiannual interest notes, each for the sum of \$180, the first maturing in 6 months after date, and the last maturing in 120 months after date, and that said defendants Wm. P. Kessler and Lena Kessler executed their deed of trust on said lands to said Naxera and Knight to secure the payment of said notes. That under and by virtue of the terms of said deed of trust the defendants were permitted to pay sums of \$300 or multiple of said amount at any interest-paying period, that is, at the end of any six months, and to discharge the indebtedness, including the interest, to that extent. That said notes for \$6,000 and said \$500 cash constituted the whole and entire consideration for the purchase price of said lands,



and that said \$500 in cash and the execution of said principal note, with interest notes, constituted the entire consideration, and was all that was paid or given by said defendants for said lands. That since the execution of said deed, the defendant Wm. P. Kessler has paid and discharged two of said interest notes, amounting to the sum of \$180 each, and that he has expended in repairing the buildings and in making improvements on said lands the sum of \$276.65. That the plaintiffs have paid one installment of rent amounting to the sum of \$56, and that same was received and appropriated by said defendant Wm. P. Kessler, and that said defendants, Kessler and wife, claim said property as their own by virtue of said purchase. All things considered, it is found by the court that the defendant Wm. P. Kessler, occupying the fiduciary relation of president of said Prairie Slough Fishing & Hunting Club, in acquiring the title to said property for himself and his wife, was not acting in good faith, but in fraud to said club and its members, and that in equity and good conscience it should be decreed that he and his codefendant, Lena Kessler, held the said property in trust for the plaintiff.

"It is therefore ordered, adjudged, and decreed that the title to said property be divested from the defendants, Wm. P. Kessler and Lena Kessler, and vested in the plaintiff, the Prairie Slough Fishing & Hunting Club, on condition, however, that the said plaintiff, the Prairie Slough Fishing & Hunting Club, on or before the 18th day of October, 1909, reimburse said Wm. P. Kessler and repay to him the sum of \$500, paid by said Kessler on the purchase price of said lands, and repay to him the sum of \$276.65, the amount expended by him in improvements on said lands, and also repay to him the sum of \$360 paid by said Kessler on said interest notes, less, however, the sum of \$56 received by said Kessler as rent on said property under the terms of said lease. It is further ordered by the court that all unpaid rents accruing during the year 1909 and subsequent shall belong to the plaintiff. It is therefore ordered, adjudged, and decreed by the court that the plaintiff, the Prairie Slough Fishing & Hunting Club, take up so as to release therefrom the defendants, Wm. P. Kessler and Lena Kessler, the said \$6,000 note and the said interest notes executed by Kessler and wife to Naxera and Knight, so as to relieve and release said Wm. P. Kessler and Lena Kessler from all liability thereon, and that on compliance with said order by said plaintiff that the title to said lands vest in plaintiff as heretofore decreed by the court. And it is ordered by the court that plaintiff make due report as to its compliance with this order on the first day of the next regular term, to wit, the October term, 1909. It is further ordered, adjudged, and decreed by the court that all costs of this proceeding be taxed against the defendants, and that plaintiff have execution therefor on the payment and discharge by it of the principal note and the interest notes and the cash items hereinbefore set forth."

The plaintiff showed compliance with the requirements of the interlocutory decree, and presented to the court the notes given in payment of the purchase price by defendants; said notes containing indorsements thereon to the effect that defendants were released from all further liability thereon, and further deposited in court, for the benefit of said William P. Kessler, as required by the interlocutory decree, the sum of \$1,080.65, and thereupon the interlocutory decree was made final and absolute, and the title to said land was divested out of defendants and vested in plaintiff. In due time defendants perfected an appeal to this court.

WILLIAMS, C. (after stating the facts as above). Appellants first contend that the plaintiff corporation has no right or power to acquire the land in question, and that therefore the court erred in divesting the title to said land out of defendants and vesting the same in plaintiff. Respondent takes the position that it does have the right and power to acquire the said land, and, furthermore, that the question cannot be raised by appellants, but by the state alone in a proper proceeding. These two propositions will be treated in their order.

It is a well-settled rule that when the organic or statutory law specifies the powers a given corporation may exercise, or the property it may hold, such specification by implication excludes all other powers or rights, except such incidental or subordinate rights and powers as may be necessary to an exercise of the powers and rights expressly given. *Blair v. Insurance Co.*, 10 Mo. 559, 47 Am. Dec. 129; *Pacific R. Co. v. Seely*, 45 Mo. 212, 100 Am. Dec. 369; *State ex rel. v. Lincoln Trust Co.*, 144 Mo. 562, 46 S. W. 593; *Carroll v. Campbell*, 108 Mo. 550, 17 S. W. 884; *State ex rel. v. Murphy*, 130 Mo. 10, 31 S. W. 594, 31 L. R. A. 798; 1 *Clark & Marshall on Private Corp.* p. 380; 3 *Thompson on Corp.* (2d Ed.) § 2771; *Case v. Kelly*, 133 U. S. 21, 10 Sup. Ct. 216, 33 L. Ed. 513.

The above rule seems also to have found lodgment in our statutory law with reference to the real estate corporations may hold. Section 2990, R. S. 1909, defining and enumerating corporate powers generally, provides in the fourth subdivision thereof that corporations may hold such real estate as the purposes of the corporation shall require, "not exceeding the amount limited in its charter or the law creating it." The respondent corporation was organized under and by virtue of article 11, c. 12, R. S. 1899 (now article 10, c. 33, R. S. 1909). Incorporation under that statute is not authorized except for purposes benevolent, religious, scientific, or educational. By section 3433 of said article 10 (R. S. 1909), it is provided that any such corporation, when organized for the above purposes, "may acquire and hold in its own name such real estate and buildings as may be necessary for assembly, library, laboratory and other rooms requisite for its purposes, and may receive income from such other rooms as may be requisite to the completeness of such buildings." The quoted portion was added to said

section by an act approved March 30, 1887 (Laws 1887, p. 115). Prior to that amendment such corporations were only permitted to acquire and hold shares of stock in a corporation incorporated pursuant to law for the "sole purpose of erecting or purchasing a hall or building for the use and benefit of any one or more of such corporations."

Respondent's articles of agreement set forth the purposes of its incorporation as follows: "The purposes of this corporation are benevolent, scientific and educational; they are to promote fish culture, to promote and facilitate fishing and hunting, boating, field sports and other rational amusements, and to promote and provide for intellectual recreation for its members and guests, and to acquire or lease such lakes and lands and other property as are necessary for such purposes." The articles of agreement apparently intended to also embrace the purposes enumerated in section 1406, R. S. 1899; but said section, in so far as it enlarges upon the purposes designated as benevolent, religious, scientific, or educational, was declared unconstitutional in *State ex rel. v. Lesueur*, 99 Mo. loc. cit. 558, 13 S. W. 237, 7 L. R. A. 734, and it was omitted from the Revision of 1909. The fact that respondent's articles of agreement enumerated purposes other than benevolent, religious, scientific, or educational, could in no way operate to give it power to acquire real estate for such additional purposes. The reason why the Legislature thus limits the power of such corporations to acquire real estate becomes apparent when it is recalled that associations incorporating under this article are permitted to do so without making payment of the incorporation fees or taxes exacted of manufacturing and business corporations. If such corporations were given the power to acquire real estate without restriction, it might lead to many abuses, and many such corporations might become holders of large tracts of land, and operate for pecuniary benefit—a thing which the Legislature doubtless foresaw and undertook to prevent.

The large tract of land in controversy here consists of portions fit for hunting and fishing purposes, and other portions suitable for agricultural purposes, and it was clearly not necessary that the corporation acquire the same for assembly, library, laboratory, etc., uses, in connection with any benevolent, religious, scientific, or educational purpose which it might have, and it was not therefore such as the respondent was empowered to acquire and hold.

But respondent insists that this point can be taken advantage of by the state alone in an appropriate proceeding, and that such defense cannot be invoked by appellants. It is true that an unwarranted exercise of corporate power ordinarily cannot be questioned in a collateral or indirect way by an individual. A careful review of the authorities, however, discloses that this rule is applied to situations quite different from the present one. After the corporation has transgressed its powers and acquired the property, then the general rule above referred to prevails; but where, as here, the corporation has not yet acquired the



property, a court of equity will not lend its aid and power to cause to be conveyed to the corporation that which by its charter law it is not permitted to hold, and such a defense is available to an interested individual. *Pacific R. R. Co. v. Seely et al.*, 45 Mo. 212, 100 Am. Dec. 369; *Land v. Coffman*, 50 Mo. 243; *Garrett v. Kansas City Coal Mining Co.*, 113 Mo. loc. cit. 339, 20 S. W. 965, 35 Am. St. Rep. 713; 10 Cyc. p. 1135; *Case v. Kelly*, 133 U. S. 21, 10 Sup. Ct. 216, 33 L. Ed. 513; *South, etc., R. Co. v. Highland Ave., etc., Ry. Co.*, 119 Ala. 105, 24 South. 114; 4 *Clark & Marshall Private Corp.* § 230, p. 254; 3 *Thompson on Corporations* (2d Ed.) § 2393.

In the case of *Garrett v. Kansas City Coal Mining Co.*, *supra*, the court, discussing an analogous situation, says: "Neither are we embarrassed in this case with questions of estoppel, which might arise were we dealing with an unauthorized and ultra vires contract which had already been executed by the corporation and stockholders. Here we are asked to require the corporation to perform an executory contract between others which it would have no authority itself to make. This we cannot do."

In *Case v. Kelly*, *supra*, the receiver of a railroad company, by suit similar to this, sought to recover from the defendants certain lands which they, as officials of the company, had received from divers persons as donations for the company; title having been taken in their individual names. The court, in denying relief, says: "It is next objected to the principle adopted by the court that the limitation upon the power of the corporation to receive land is one which concerns the state alone, and the title to such lands in a corporation can only be defeated by a proceeding in the nature of a quo warranto on behalf of the state. \* \* \* The railroad company is plaintiff in this action, and is seeking to obtain the title to such lands. It has no authority by the statute to receive such title and to own such lands, and the question here is, not whether the courts would deprive it of such lands if they had been conveyed to it, but whether they will aid it to violate the law and obtain a title which it has no power to hold. We think the questions are very different ones, and that while a court might hesitate to declare the title to lands received already, and in the possession and ownership of the company, void on the principle that they had no authority to take such lands, it is very clear that it will not make itself the active agent in behalf of the company in violating the law and enabling the company to do that which the law forbids." 133 U. S. loc. cit. 28, 10 Sup. Ct. 220, 33 L. Ed. 513.

The rule is stated by Mr. Thompson as follows: "A corporation cannot compel the specific performance of a contract to convey land to it where it has no power to take real estate for the purpose stated in the contract; and in such case the owner of the land, or his heirs, may defend on the ground of the incapacity of the corporation. Generally, where the corporation seeks the necessary aid of a court to perfect its

title, then an interested individual may question the corporation's power to take the real estate. \* \* \* A court of equity will not aid a corporation to acquire land where it is expressly or impliedly forbidden so to do either by law or by its charter." 3 Thompson on Corporations (2d Ed.) § 2393.

By reason of the views above expressed it becomes unnecessary to discuss appellants' other assignments of error. The judgment is reversed and the cause remanded.

ROY, C., concurs.

PER CURIAM. The above opinion of WILLIAMS, C., is adopted as the opinion of the court. All the Judges concur.

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## X. Ultra Vires Contracts<sup>13</sup>

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CENTRAL TRANSP. CO. v. PULLMAN'S PALACE CAR CO.  
(Supreme Court of United States, 1890. 139 U. S. 24, 11 Sup. Ct. 478, 35 L. Ed. 55.)

In error to the circuit court of the United States for the eastern district of Pennsylvania.

Action of covenant brought September 21, 1886, by the Central Transportation Company, a Pennsylvania corporation, v. Pullman's Palace Car Company, an Illinois corporation, to recover the sum of \$198,000, due for the last three-quarters of the year ending July 1, 1886, according to the terms of an indenture of lease entered into between plaintiff and defendant, whereby plaintiff leased all of its personal property to the defendant. This lease was dated February 17, 1870. Plaintiff's incorporation certificate stated that its object of formation was the transportation of passengers in railroad cars to be constructed and owned by it in accordance with certain patent rights which it owned. Defendant company was organized under a special act of the Illinois legislature in order "to manufacture, construct and purchase railway cars, with all convenient appendages and supplies for persons traveling therein, and the same to sell or use or permit to be used in such manner and upon such terms as the said company may think fit and proper." The indenture of lease above referred to, whereby plaintiff leased all of its property to defendant, was to run for a period of ninety-nine years, and plaintiff agreed further not to engage in the business of manufacturing and using or hiring sleeping cars during the term of said indenture of lease. Defendant agreed to pay to plaintiff the annual sum of \$264,000 as rental.

<sup>13</sup> For discussion of principles, see Clark on Corp. (3d Ed.) §§ 67, 68.

Plaintiff offered to prove at the trial that defendant had enjoyed the use and possession of plaintiff's property during the three-quarters of the year ending July 1st, 1886. Defendant objected to the introduction of this evidence, claiming that it was ultra vires of both corporations to enter into the contract of lease. Defendant's objection was sustained. Plaintiff duly excepted. Plaintiff was ultimately non-suited in the court below, and from the judgment of non-suit plaintiff sues out this writ of error.

Mr. JUSTICE GRAY.<sup>14</sup> The principal defense in this case, duly made by the defendant, by formal plea, as well as by objection to the plaintiff's evidence, and sustained by the Circuit Court, was that the indenture of lease sued on was void in law, because beyond the powers of each of the corporations by and between whom it was made. \* \* \*

It was therefore rightly assumed by the counsel of both parties at the argument that the only question to be determined is one of the correctness of the ruling sustaining the defense of ultra vires, independently of the form in which that question was presented and disposed of.

Upon the authority and the duty of a corporation to exercise the powers granted to it by the legislature, and those only; and upon the validity of any contract, made beyond those powers, or providing for their disuse or alienation; there is no occasion to refer to decisions of other courts, because the judgments of this court, especially those delivered in the last twelve years, by the late Mr. Justice Miller, afford satisfactory guides and ample illustrations. \* \* \*

The clear result of these decisions may be summed up thus: The charter of a corporation, read in the light of any general laws which are applicable, is the measure of its powers, and the enumeration of those powers implies the exclusion of all others not fairly incidental. All contracts made by a corporation beyond the scope of those powers are unlawful and void, and no action can be maintained upon them in the courts, and this upon three distinct grounds: The obligation of every one contracting with a corporation, to take notice of the legal limits of its powers; the interest of the stockholders, not to be subjected to risks which they have never undertaken; and, above all, the interest of the public, that the corporation shall not transcend the powers conferred upon it by law. A corporation cannot, without the assent of the legislature, transfer its franchise to another corporation and abnegate the performance of the duties to the public, imposed upon it by its charter as the consideration for the grant of its franchise. Neither the grant of a franchise to transport passengers, nor a general authority to sell and dispose of property, empowers the grantee, while it continues to exist as a corporation, to sell or to lease its entire property and franchise to another corporation. These principles apply equally to companies incorporated by special charter from

<sup>14</sup> Statement of facts is abridged and portions of the opinion are omitted.



the legislature, and to those formed by articles of association under the general laws. \* \* \*

The plaintiff, therefore, was not an ordinary manufacturing corporation, such as might, like a partnership or an individual engaged in manufactures, sell or lease all its property to another corporation. *Ardesco Oil Co. v. North American Oil Co.*, 66 Pa. 375; *Treadwell v. Salisbury Manuf. Co.*, 7 Gray (Mass.) 393, 66 Am. Dec. 490. But the purpose of its incorporation, as defined in its charter, and recognized and confirmed by the legislature, being the transportation of passengers, the plaintiff exercised a public employment, and was charged with the duty of accommodating the public in the line of that employment, exactly corresponding to the duty which a railroad corporation or a steamboat company as a carrier of passengers, owes to the public, independently of possessing any right of eminent domain. The public nature of that duty was not affected by the fact that it was to be performed by means of cars constructed and of patent rights owned by the corporation, and over roads owned by others. The plaintiff was not a strictly private, but a quasi public corporation; and it must be so treated as regards the validity of any attempt on its part to absolve itself from the performance of those duties to the public, the performance of which by the corporation itself was the remuneration that it was required by law to make to the public in return for the grant of its franchise. *Pickard v. Pullman Southern Car Co.*, 117 U. S. 34, 6 Sup. Ct. 635, 29 L. Ed. 785; *York & Maryland Railroad v. Winans*, 17 How. 31, 39, 15 L. Ed. 27; *Railroad Co. v. Lockwood*, 17 Wall. 357, 21 L. Ed. 627; *Liverpool & Great Western Steam Co. v. Phenix Ins. Co.*, 129 U. S. 397, 9 Sup. Ct. 469, 32 L. Ed. 788.

The evident purpose of the legislature, in passing the statute of 1870, was to enable the plaintiff the better to perform its duties to the public, by prolonging its existence, doubling its capital, and confirming, if not enlarging, its powers. An intention that it should immediately abdicate those powers, and cease to perform those duties, is so inconsistent with that purpose, that it cannot be implied without much clearer expressions of the legislative will looking towards that end, than are to be found in this statute.

The provision of this statute, by which the plaintiff is empowered to contract with other corporations "for the leasing or hiring and transfer to them, or any of them," of its "railway cars and other personal property," is fully satisfied by construing it as confirming the plaintiff's right to do as it had been doing, to "lease" or "hire" (which are equivalent words) to other corporations in the regular course of its business, and to "transfer" under such leasing or hiring, its "railway cars," and "other personal property" either connected with the cars, or at least of the same general nature of tangible property. It can hardly be stretched to warrant the plaintiff in making to a single corporation an absolute transfer, or a long lease, of all that might

be comprehended in the words "personal property" in their widest sense, including not only goods and chattels, but moneys, credits and rights of action. In any view, it would be inconsistent alike with the main purpose of the statute, and with the uniform course of decision in this court, to construe these words as authorizing the plaintiff to deprive itself, either absolutely, or for a long period of time, of the right to exercise the franchise granted to it by the legislature for the accommodation of the public. \* \* \*

Considering the long term of the indenture, the perishable nature of the property transferred, the large sums to be paid quarterly by the defendant by way of compensation, its assumption of the plaintiff's debts, and the frank avowal, in the indenture itself, of the intention of the two corporations to prevent competition and to create a monopoly, there can be no doubt that the chief consideration for the sums to be paid by the defendant was the plaintiff's covenant not to engage in the business of manufacturing, using or hiring sleeping cars; and that the real purpose of the transaction was, under the guise of a lease of personal property, to transfer to the defendant nearly the whole corporate franchise of the plaintiff, and to continue the plaintiff's existence for the single purpose of receiving compensation for not performing its duties.

The necessary conclusion from these premises is, that the contract sued on was unlawful and void, because it was beyond the powers conferred upon the plaintiff by the legislature, and because it involved an abandonment by the plaintiff of its duty to the public. \* \* \*

It was argued in behalf of the plaintiff that, even if the contract sued on was void, because ultra vires and against public policy, yet that, having been fully performed on the part of the plaintiff, and the benefits of it received by the defendant, for the period covered by the declaration, the defendant was estopped to set up the invalidity of the contract as a defense to this action to recover the compensation agreed on for that period.

But this argument, though sustained by decisions in some of the states, finds no support in the judgments of this court. \* \* \*

In Pittsburgh &c. Railway v. Keokuk & Hamilton Bridge, it was stated, as the result of the previous cases in this court, that "a contract made by a corporation, which is unlawful and void because beyond the scope of its corporate powers, does not, by being carried into execution, become lawful and valid, but the proper remedy of the party aggrieved is by disaffirming the contract and suing to recover, as on a quantum meruit, the value of what the defendant has actually received the benefit of." 131 U. S. 371, 389, 9 Sup. Ct. 770, 776, 33 L. Ed. 157.

The view which this court has taken of the question presented by this branch of the case, and the only view which appears to us consistent with legal principles, is as follows:



A contract of a corporation, which is ultra vires, in the proper sense, that is to say, outside the object of its creation as defined in the law of its organization, and therefore beyond the powers conferred upon it by the legislature, is not voidable only, but wholly void, and of no legal effect. The objection to the contract is, not merely that the corporation ought not to have made it, but that it could not make it. The contract cannot be ratified by either party, because it could not have been authorized by either. No performance on either side can give the unlawful contract any validity, or be the foundation of any right of action upon it.

When a corporation is acting within the general scope of the powers conferred upon it by the legislature, the corporation, as well as persons contracting with it, may be estopped to deny that it has complied with the legal formalities which are prerequisites to its existence or to its action, because such requisite might in fact have been complied with. But when the contract is beyond the powers conferred upon it by existing laws, neither the corporation, nor the other party to the contract, can be estopped, by assenting to it, to show that it was prohibited by those laws.

The doctrine of the common law, by which a tenant of real estate is estopped to deny his landlord's title, has never been considered by this court as applicable to leases by railroad corporations of their roads and franchises. It certainly has no bearing upon the question whether this defendant may set up that the lease sued on, which is not of real estate, but of personal property, and which includes, as inseparable from the other property transferred, the inalienable franchise of the plaintiff, is unlawful and void for want of legal capacity in the plaintiff to make it.

A contract ultra vires being unlawful and void, not because it is in itself immoral, but because the corporation, by the law of its creation, is incapable of making it, the courts, while refusing to maintain any action upon the unlawful contract, have always striven to do justice between the parties, so far as could be done consistently with adherence to law, by permitting property or money, parted with on the faith of the unlawful contract, to be recovered back, or compensation to be made for it.

In such case, however, the action is not maintained upon the unlawful contract, nor according to its terms; but on an implied contract of the defendant to return, or, failing to do that, to make compensation for, property or money which it has no right to retain. To maintain such an action is not to affirm, but to disaffirm, the unlawful contract.

The ground and the limits of the rule concerning the remedy, in the case of a contract ultra vires, which has been partly performed, and under which property has passed, can hardly be summed up better than they were by Mr. Justice Miller in a passage already quoted,



where he said that the rule "stands upon the broad ground that the contract itself is void, and that nothing which has been done under it, nor the action of the court, can infuse any vitality into it;" and that "where the parties have so far acted under such a contract that they cannot be restored to their original condition, the court inquires if relief can be given independently of the contract, or whether it will refuse to interfere as the matter stands." *Pennsylvania Railroad v. St. Louis &c. Railroad*, 118 U. S. 317, 6 Sup. Ct. 1106, 30 L. Ed. 83.

Whether this plaintiff could maintain any action against this defendant, in the nature of a quantum meruit, or otherwise, independently of the contract, need not be considered, because it is not presented by this record, and has not been argued. This action, according to the declaration and the evidence, was brought and prosecuted for the single purpose of recovering sums which the defendant had agreed to pay by the unlawful contract, and which, for the reasons and upon the authorities above stated, the defendant is not liable for. Judgment affirmed.

### MONUMENT NAT. BANK v. GLOBE WORKS.

(Supreme Judicial Court of Massachusetts, 1869. 101 Mass. 57, 3 Am. Rep. 322.)

HOAR, J. The single question presented for our decision in this cause, all others which arise upon the report having been waived, is, whether the note of a manufacturing corporation, in the hands of a holder in good faith for value, who took it before maturity, and without any knowledge that the makers had not received the full consideration, cannot be enforced against them, because it was in fact made as an accommodation note.

The argument for the defendants takes the ground that to issue an accommodation note is not within the powers conferred upon the corporation; and that, as any persons taking it had notice that it was the note of the corporation, they had notice that it was of no validity unless issued for a purpose within the scope of the corporate powers, and were therefore bound to ascertain not only that it was executed by the officer of the corporation who had the general authority to sign the notes which they might lawfully make, but that the purpose for which it was issued was such as the charter authorized them to entertain and execute.

The court are all of opinion that this position is not tenable, and that the defence cannot be maintained.

It has long been settled in this Commonwealth that a manufacturing corporation has the power to make a negotiable promissory note. *Naragansett Bank v. Atlantic Silk Co.*, 3 Metc. 282. And it was held in *Bird v. Daggett*, 97 Mass. 494, as a just corollary to that proposition, that such a note in the hands of a holder in good faith for value is

binding upon the maker, although made as an accommodation note. The question was not discussed, nor the reasons for the decision fully stated, in *Bird v. Daggett*; but it was assumed that the doctrine announced was clear and undoubted law.

The doctrine of ultra vires has been carried much farther in England than the courts in this country have been disposed to extend it; but, with just limitations, the principle cannot be questioned, that the limitations to the authority, powers and liability of a corporation are to be found in the act creating it. And it no doubt follows, as claimed by the learned counsel for the defendants, that when powers are conferred and defined by statute, every one dealing with the corporation is presumed to know the extent of those powers.

But when the transaction is not the exercise of a power not conferred on a corporation, but the abuse of a general power in a particular instance, the abuse not being known to the other contracting party, the doctrine of ultra vires does not apply. As was said by Selden, J., in *Bissell v. Michigan Southern & Northern Indiana Railroad Co.*, 22 N. Y. 289, 290: "There are no doubt cases in which a corporation would be estopped from setting up this defense, although its contract might have been really unauthorized. It would not be available in a suit brought by a bona fide indorsee of a negotiable promissory note, provided the corporation was authorized to give notes for any purpose; and the reason is, that the corporation by giving the note, has virtually represented that it was given for some legitimate purpose, and the indorsee could not be presumed to know the contrary. The note, however, if given by a corporation absolutely prohibited by its charter from giving notes at all, would be voidable not only in the hands of the original payee, but in those of any subsequent holder; because all persons dealing with a corporation are bound to take notice of the extent of its chartered powers. The same principle is applicable to contracts not negotiable. When the want of power is apparent upon comparing the act done with the terms of the charter, the party dealing with the corporation is presumed to have knowledge of the defect, and the defence of ultra vires is available against him. But such a defence would not be permitted to prevail against a party who cannot be presumed to have had any knowledge of the want of authority to make the contract. Hence, if the question of power depends not merely upon the law under which the corporation acts, but upon the existence of certain extrinsic facts, resting peculiarly within the knowledge of the corporate officers, then the corporation would be estopped from denying that which, by assuming to make the contract, it had virtually affirmed."

This doctrine seems to us sound and reasonable; and in conformity with it, it was held in *Farmers' & Mechanics' Bank v. Empire Stone Dressing Co.*, 5 Bosw. (N. Y.) 275, that an accommodation acceptance by an officer of a manufacturing corporation, on behalf of the company, was not binding, unless the consideration had been advanced upon the faith of the acceptance; but that if the consideration was paid

in good faith after the acceptance, and upon the credit of it, it could be enforced.

So it was said by Lord St. Leonards that he felt a disposition "to restrain the doctrine of ultra vires to clear cases of excess of power, with the knowledge of the other party, express or implied from the nature of the corporation, and of the contract entered into." *Eastern Counties Railway Co. v. Hawkes*, 5 H. L. Cas. 331, 373.

The cases on which the defendants rely are cases against municipal corporations, in respect to which the rule is much more rigid, or for the most part those in which the other contracting party had notice upon the face of the transaction of the want of corporate power.

There can be no doubt that it is very often true that a corporation may be responsible for the unauthorized, and even for the unlawful acts of its agents, apparently clothed with its authority. No corporation is empowered by its charter to commit an assault and battery; yet it has frequently been held accountable, in this Commonwealth, for one committed by its servants. Bills of a bank issued without consideration, even stolen, are good in the hands of an innocent holder for value.

Many other illustrations might be given, but enough has been said to show the principle on which our decision rests. Judgment for the plaintiffs.

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### BLACKWOOD v. LANSING CHAMBER OF COMMERCE.

(Supreme Court of Michigan, 1914. 178 Mich. 321, 144 N. W. 823.)

Error to Circuit Court, Ingham County; Charles B. Collingwood, Judge.

Action by Samuel E. Blackwood against the Lansing Chamber of Commerce. Judgment for defendant, and plaintiff brings error. Reversed, and new trial ordered.

BIRD, J. The plaintiff, who was a vendor of talent for local Chautauquas, entered into a written agreement with defendant in November, 1909, to hold a Chautauqua in Lansing in the summer of 1910, and to furnish the speakers and entertainers therefor. The contract was as follows: "This contract entered into the 18th day of November, 1909, by and between S. E. Blackwood, representing the Redpath-Slayton Company of Chicago, party of the first part, and the Lansing Business Men's Association, of the second part, witnesseth: That said party of the first part, for and in consideration of the sale of five hundred (500) season tickets, at two dollars each, by said party of the second part, agrees to stand liable for the payment of all necessary expenses, and pay any deficit for the successful carrying on of a Chautauqua, to be held in Lansing, in the summer of 1910, the dates and program for said Chautauqua to be mutually agreed upon. Said party of the second part to proceed with due diligence to sell the five hundred (500) tickets on or before April 1, 1910. After which date said



party of the first part is to undertake to sell additional season tickets. It is further understood and agreed by the parties hereunto that the net profits accruing in this enterprise are to be divided between them. It is further understood that the total expense of this enterprise is not to exceed the sum of twenty-two hundred dollars (\$2,200.00)." Following the making of this contract, the plaintiff met with a committee appointed by defendant, and arranged for the dates of holding the Chautauqua, and also agreed upon the speakers and entertainers to be secured by plaintiff.

It is the claim of plaintiff that he carried out his part of the contract, but that the defendant failed to carry out its part, in that it failed to sell the 500 tickets at \$2 each, which the contract stipulated it should sell, and by reason of such failure the Chautauqua was a failure financially, and in consequence thereof he was greatly damaged. To recover this loss, he brought this suit against the defendant, and filed a declaration counting upon the breach of the contract, with the common counts added. The defendant pleaded the general issue, and gave notice that, if the defendant ever became obligated as claimed by plaintiff, it compromised and settled for its delinquency by moving plaintiff's tent, in which the Chautauqua was being held, from East Lansing to the West Side Park, after the Chautauqua was under way. The case was tried along the lines raised by the pleadings, and, when the proofs were closed, the defendant raised the question, and asked for a direct verdict, on the ground that the contract was one which the defendant corporation had no authority to make, and was therefore ultra vires. The trial court took this view of the contract, and accordingly directed a verdict as requested. Whether the action of the trial court was right in so doing is the principal question before us for solution.

1. The plaintiff raises the question that the trial court was in error in allowing the defense of ultra vires to be made over his objection that it was not raised by the pleadings. It has been several times held by this court that the defense of ultra vires is a special defense, and is not available under the general issue, but must be specially pleaded. Circuit Court Rule 7; *Citizens' Savings Bank v. Globe Brass Works*, 155 Mich. 3, 118 N. W. 507; *City of Niles v. Railway*, 154 Mich. 378, 117 N. W. 937; *Wachsmuth v. Bank*, 96 Mich. 426, 56 N. W. 9, 21 L. R. A. 278.

Under the practice as established by the rule and these authorities, we think the objection was well taken, and that that defense was not open to the defendant under the pleadings as they were framed.

2. Defendant was incorporated under section 6892 et seq. of Compiled Laws of 1897. It adopted a constitution, in which was set out the object of the corporation. It is defendant's claim that, under the statute and its constitution, it had no authority to make a contract for such a purpose. The contract appears to have been made in good faith by both parties, and it further appears to have been carried out by

plaintiff. There was nothing criminal, immoral, nor against public policy in promoting a Chautauqua which would contribute to the intellectual and moral welfare of the people. For defendant to refuse to discharge its obligations growing out of the contract, when plaintiff had in good faith discharged his, would work an injustice. Under such a state of facts, if it be true, as defendant contends, that the contract is such a one as it had no power to make, it ought to be and is estopped from raising the defense of ultra vires. The doctrine applicable to like situations has been stated as follows: "Except in cases where the rights of the public are involved, the plea of ultra vires, whether interposed for or against a corporation, will not be allowed to prevail when it will not advance justice, but will accomplish a legal wrong. The great mass of judicial authority seems to be to the effect that, where a private corporation has entered into a contract in excess of its granted powers, and has received the fruits or benefits of the contract, and an action is brought against it to enforce the obligation on its part, it is estopped from setting up the defense that it had no power to make it." 10 Cyc. 1156; Day v. Buggy Co., 57 Mich. 151, 23 N. W. 628, 58 Am. Rep. 352; Carson City Sav. Bank v. Elevator Co., 90 Mich. 550, 51 N. W. 641, 30 Am. St. Rep. 454; Dewey v. Railway, 91 Mich. 351, 51 N. W. 1063; Butterworth & Lowe v. Kritzer Milling Co., 115 Mich. 1, 72 N. W. 990; Rehberg v. Tontine Surety Co., 131 Mich. 135, 91 N. W. 132; Timm v. Grand Rapids Brewing Co., 160 Mich. 371, 125 N. W. 357, 27 L. R. A. (N. S.) 186.

We think the trial court was in error in directing a verdict for the defendant on the ground stated. The questions of fact which the testimony raised should have been submitted to the jury. The judgment will be reversed, and a new trial ordered.

#### BATH GASLIGHT CO. v. CLAFFY.

(Court of Appeals of New York, 1896. 151 N. Y. 24, 45 N. E. 390, 36 L. R. A. 664.)

Appeal from supreme court, general term, Second department.

Action by the Bath Gaslight Company against John Claffy, impleaded with the United Gas, Fuel & Light Company and John T. Rowland, to recover against defendant Claffy as one of the sureties on the bond given by defendant company to plaintiff to secure the performance of a lease made by plaintiff to defendant company of all its property and franchises for a term of 25 years. From a judgment of the general term (74 Hun, 638, 26 N. Y. Supp. 287) affirming a judgment in favor of plaintiff entered on a decision by the court, a jury trial having been waived, defendant Claffy appeals. Affirmed.

ANDREWS, C. J.<sup>15</sup> A brief statement of the material facts will present the important question arising upon this appeal. The plaintiff

<sup>15</sup> Portions of the opinion are omitted; the dissenting opinion is omitted.

is a Maine corporation, created under a special law of that state passed in 1853, for the purpose of supplying gas for the lighting of the streets and buildings in the city of Bath. The United Gas, Fuel & Light Company is also a Maine corporation, organized in 1888, under a general law, by the execution and filing of a certificate, which, in pursuance of the law of Maine, was first submitted to and approved by the attorney general, who certified that it was conformable to the constitution and laws of that state. The certificate, among other things, specified that the corporation was organized to "manufacture, lease, purchase, and otherwise acquire, deal in, manage, use, and sell any and all machinery, fixtures, appurtenances, appliances, and plants for using and furnishing light, heat, and power, and for any and all purposes for which gas is now used." The plaintiff, under its charter, established a plant, and at the time of the execution of the lease now to be mentioned was engaged in supplying the streets and buildings in Bath with gas for lighting and other purposes. On the 10th day of November, 1888, it executed to the United Gas, Fuel & Light Company a lease of its property and franchises for the term of 25 years from November 1, 1888, at an annual rent of \$2,500, which the lessee covenanted to pay in semiannual payments on the 1st day of May and the 1st day of November in each year, and also the taxes assessed during the term. Provision was made for the payment by the lessor to the lessee, at the expiration of the term, of the value of any improvements or extensions made by the lessee; and it was also provided that the lessee should give to the lessor a satisfactory bond for the faithful performance by the lessee of its covenants in the lease.

In pursuance of the provision last mentioned, the United Gas, Fuel & Light Company on the same day executed a bond with the defendants John Claffy and John T. Rowland as sureties, conditioned for the faithful performance by the company of the covenants in its behalf contained in the lease, which bond was delivered to and accepted by the plaintiff. The sureties were interested in the United Gas, Fuel & Light Company as stockholders, and Claffy (the appellant) was also a director. The lessee immediately, upon the execution of the lease, entered into possession of the demised property, and paid the rent up to the 1st day of November, 1889, but defaulted in the semiannual payment due May 1, 1890, and on the 2d day of August, 1890 (the rent remaining unpaid), the plaintiff re-entered, and took possession of the demised property under a provision of the lease which authorized the lessor to enter and expel the lessee on failing to pay rent. The entry also was, as may be inferred, with the consent, and, indeed, at the suggestion, of the officers of the lessee.

This action was brought on the bond against the lessee and the sureties to recover as damages the rent which fell due May 1, 1890, and the proportionate rent from that date up to August 2, 1890, and taxes which had been assessed against the property during its occupation by the lessee, which it had failed to pay. The defendant Claffy alone ap-



peared, and defended the action. His sole defense to the general claim is that the lease was *ultra vires*, illegal, and void, because (as is conceded) it was made without legislative sanction. If the court is compelled to accede to this contention by force of controlling authority, or from considerations of public policy which overbear in the particular case the rules of ordinary justice, it will be our duty so to declare, and to say that, although the United Gas, Fuel & Light Company received and enjoyed the undisturbed possession of the demised property under the lease until the re-entry, and accepted and appropriated the benefit of the contract, nevertheless, when called upon to pay the rent which accrued during its occupation, it may defend itself on the ground that the plaintiff, in making the lease, exceeded its power, and escape the performance of its obligation; and, further, that the defendant Claffy may, for a like reason, avoid his guaranty.

The modern doctrine, as stated by Chancellor Kent, is to consider corporations as having such powers as are specifically granted by the act of incorporation, or as are necessary for the purpose of carrying into effect the powers expressly granted, and as not having any others. 2 Kent, Comm. 299. This doctrine is embodied in the Revised Statutes of New York, and the section relating to the subject is regarded as simply declaratory of the antecedent law. 1 Rev. St. 600, § 3. It has been frequently stated that the validity of contracts of corporations is to be determined by comparing the contract made with the charter, and if, upon such comparison, it appears that the contract was neither expressly authorized nor a necessary or reasonable incident to the exercise of the powers specifically granted, the contract is *ultra vires*. It seems that by the ancient common law a corporation could bind itself by a contract under its corporate seal, although the contract was not within the powers specified in the charter, and even although it contained negative words.

This was, in substance, stated by Blackburn, J., in the case of *Riche v. Iron Co.*, L. R. 9 Exch. 262, citing as authority *Sutton's Hospital Case*, 10 Coke, 1. He said: "If there are conditions contained in the charter that the corporation shall not do particular things, and those things are nevertheless done, it gives ground for a proceeding by *sci. fa.* in the name of the crown to repeal the letters patent creating the corporation. But, if the crown take no such steps, it does not, as I conceive, lie in the mouth either of the corporation or of the person who has contracted with it to say that the contract into which they have entered was void as beyond the capacity of the corporation." The case came before the house of lords on appeal from the decision of the exchequer chamber in favor of the plaintiff, and its judgment is reported in L. R. 7 H. L. 653. The action was to enforce a contract entered into by the defendant, a corporation incorporated under the companies act of 1862. The judgment of the exchequer chamber was reversed on the ground that the contract sued upon was expressly prohibited by the act under which the defendant was incorporated, and

was, therefore, void. The house of lords applied the general doctrine that an act done in contravention of an express statute is utterly void.

The modern and reasonable doctrine that contracts into which corporations may lawfully enter are such only as are expressly or impliedly authorized by their charters, is nevertheless frequently disregarded in practice; and when this is done, and a corporation enters into a contract beyond its chartered powers, the question arises which has been the subject of debate, and of much contrariety of opinion, how shall such a contract be treated by the courts, and whether the contract can create any rights as between the parties which the courts will enforce. There are some propositions pertaining to the general subject which are beyond dispute. One is that a contract by a corporation to do an immoral thing, or for any immoral purpose, or, to use a convenient expression, a contract *malum in se*, is void, and gives no right of action. The doctrine, however, is not peculiar to contracts of corporations. It has its root in the universal principle that persons shall not stipulate for iniquity.

Another principle of general recognition is that a corporation cannot enter into or bind itself by a contract which is expressly prohibited by its charter or by statute; and in the application of this principle it is immaterial that the contract, except for the prohibition, would be lawful. No one is permitted to justify an act which the legislature, within its constitutional power, has declared shall not be performed. The series of cases in this state known as the "Utica Insurance Cases" afford an apt illustration. It was held that the restraining acts which prohibited the exercise of banking powers, including the discount of paper, by other than banking corporations, rendered void securities taken on such discount by corporations not possessing banking powers; and this, although the object of the restraining laws seems to have been the protection of the chartered banks in the monopoly of banking. But in not infrequent instances corporations enter into unauthorized contracts which are neither *mala in se* nor *mala prohibita*, or when the only prohibition or restriction is implied from the grant of specified powers. It is this class of cases which open the field of controversy. Is such a contract performed by one party, but not performed by the other, void as between them to all intents and purposes, so that no recovery can be had under it against the party who has received the consideration for his promise, but neglects or refuses to perform it, or is it so tainted with illegality that the courts must refuse to recognize it under any circumstances or enforce its obligation, whether as to past or future transactions?

There are certain English cases which are relied upon by those who maintain the strict view that contracts of corporations *ultra vires* are under no circumstances enforceable in the courts. The principal of these cases are *East Anglian Ry. Co. v. Eastern Counties Ry. Co.*, 11 C. B. 775, *MacGregor v. Railway Co.*, 18 Q. B. 618, and *Iron Co. v. Riche*, L. R. 7 H. L. 653. \* \* \*

Without questioning these cases, it is quite apparent that they stand in justice upon a very different basis from the action in this case, which is brought by the corporation to enforce a contract, the enforcement of which will indemnify the plaintiff and its stockholders for the deprivation of the use of the property of the corporation, during its possession by the defendants, under the unauthorized lease. The supreme court of the United States seems to be committed to a construction of the doctrine of *ultra vires* which would sustain the defense in the case now before us. Several cases have arisen in that court upon leases of railroads made without legislative sanction, in which it has been held that such leases are void as between the parties, and that no action can be maintained thereon to recover the rent reserved, even during the occupation by the lessee under the lease. In *Thomas v. Railroad Co.*, 101 U. S. 71, 25 L. Ed. 950, the defendant had leased to the plaintiffs a railroad for a term of years, reserving an option to terminate the lease at any time during the term, and the defendant, in case such option should be exercised, covenanted to submit to arbitration the ascertainment of the loss and damage to the plaintiffs by reason of such termination of the lease, and to abide by the award. The defendant exercised the option, and terminated the lease, and resumed possession of the road, and an action was brought for a breach of the contract in respect to arbitration. The trial court determined the case against the plaintiffs on the ground that the contract sued upon was, in substance, a lease of the property and franchises of the defendant, which, having been executed without legislative authority, was illegal and void; and the supreme court affirmed the judgment.

The action, it will be observed, was, in substance, an action to recover the value of the unexpired term of which the plaintiffs had been deprived by the action of the defendant, and the covenant sued upon was wholly executory. But in the subsequent cases of *Pennsylvania R. Co. v. St. Louis, A. & T. H. R. Co.*, 118 U. S. 290, 6 Sup. Ct. 1094, 30 L. Ed. 83; *Oregon Ry. & Nav. Co. v. Oregonian Ry. Co.*, 130 U. S. 1, 9 Sup. Ct. 409, 32 L. Ed. 837; and *St. Louis, V. & T. H. R. Co. v. Terre Haute & I. R. Co.*, 145 U. S. 393, 12 Sup. Ct. 953, 36 L. Ed. 748—which were actions by lessors against lessees to recover rent accrued under leases of railroads during the occupation by the lessees, it was broadly held that, as the leases were made without legislative sanction, they were void, and that no action could be maintained thereon to recover the past-due rent, although the lessees were and still remained in undisturbed possession of the demised property. Mr. Justice Miller, in the case in 118 U. S. and 6 Sup. Ct., expressed a doubt whether there could be a recovery on a quantum meruit. We concur with the opinion expressed by two of the learned justices of the court who dissented from the judgment in the case last cited, that the decision carried the doctrine of *ultra vires* to an unjust extent, and the rank injustice which, as it seems to us, these cases sanction, justifies the



observation of Lord St. Leonards in the case of *Eastern Counties Ry. v. Hawkes*, 5 H. L. Cas. 347, 370, that "the safety of men in their daily contracts requires that the doctrine of ultra vires should be confined within narrow limits."

We concede that a railroad or other corporation invested with powers in the exercise of which the public have an interest, and empowered by reason of their quasi public character to do acts and exercise privileges peculiar and exceptional to enable them to discharge their public duties, cannot, as against the public, abdicate their functions, or absolve themselves from the performance of such duties through an unauthorized transfer of their property and franchises to another body or corporation. We have so held in the case of *Abbott v. Railroad Co.*, 80 N. Y. 27, 36 Am. Rep. 572, where it was decided that a railroad corporation which, without legal sanction, had leased its road, was not thereby exempted from liability as carrier to a passenger injured by negligence during the operation of the road under the lease.

There are obvious reasons of propriety and public policy, the prevention of monopolies, among others, aside from the mere question of capacity under their charters, which enforce the now well-settled doctrine that leases by such quasi public corporations, to be valid and effectual, must be authorized by statute. But where, as in the present case such an unauthorized lease has been made, and the lessee has received and enjoyed the possession of the property under the lease, is there any public policy which requires that the lessee should be permitted to escape the obligation imposed by the contract to pay the rent reserved during the enjoyment of the property? It is doubtless true, as has been suggested, that the corporation in such cases cannot, without the consent of the state, change its obligations to the state or the public, and discharge itself from its public duties. But the law affords ample public remedy for the usurpation by corporations of unauthorized powers, through proceedings by injunction or for the forfeiture of their charters. If a lease by a corporation, made in excess of its powers, and without legislative sanction, is illegal in the ordinary and proper sense of the term, it may be properly conceded that no action could be maintained upon it. The lessee, when sued for the rent, could set up the illegality of the contract, and the defense would prevail, however inequitable the defense might be.

But the term "illegal," which is frequently used to describe a contract made by a corporation in excess of its corporate powers, in most cases means simply that the contract is unauthorized, or one which the corporation had no legal capacity to make. Such a contract may be illegal in the true and proper sense, but it may also be one involving no moral turpitude, and offending against no express statute. The inexact and misleading use of the word "illegal," as applied to contracts of corporations ultra vires only, has been frequently alluded to. *Comstock, C. J., Bissell v. Railroad Cos.*, 22 N. Y. 268; *Archibald, J., Riche*

v. Iron Co., L. R. 9 Exch. 293; Lord Cairns, same case on appeal, L. R. 7 H. L. 672.

The lease now in question was not in any true sense of the word illegal. It was undoubtedly void as against the state. The parties to the lease assumed it to be valid. It was contemplated, as the provisions of the lease show, that the lessee would continue and extend the business before carried on by the plaintiff, and it is not suggested that it did not, during its occupation, discharge all the obligations to the public which rested upon the plaintiff. The state has not intervened, and the possession of the property has now been restored to its original proprietors. The contract has been terminated as to the future, and all that remains undone is the payment by the lessee of the unpaid rent. We think the demands of public policy are fully satisfied by holding that, as to the public, the lease was void, but that, as between the parties, so long as the occupation under the lease continued, the lessee was bound to pay the rent, and that its recovery may be enforced by action on the covenant. Public policy is promoted by the discouragement of fraud and the maintenance of the obligation of contracts; and to permit a lessee of a corporation to escape the payment of rent by pleading the incapacity of the corporation to make the lease, although he has had the undisturbed enjoyment of the property, would be, we think, most inequitable and unjust.

It has been suggested, to avoid the apparent injustice which would result from holding that there could be no recovery on the contract for past-due rent, that there might be a remedy on an implied contract to pay the value of the use of the property. But, if the express contract was illegal in a proper sense, and the parties to the lease were guilty of a public wrong, so as to preclude a court of equity to entertain jurisdiction on the application of a lessor to be relieved from the lease, and to be restored to the possession of the leased property, as was held in the case of *St. Louis, V. & T. H. R. Co. v. Terre Haute & I. R. Co.*, 145 U. S. 393, 12 Sup. Ct. 953, 36 L. Ed. 748, then surely it would be a mere evasion, and would be inconsistent with legal principles, for the court to imply a contract from the occupation under the illegal lease to relieve the wrongdoer from the dilemma into which he had voluntarily placed himself. We think the rule which should be applied is that the lessee is bound by the contract so long as he remains in possession.

It is unnecessary now to determine whether a lessee under an ultra vires lease may relieve himself from liability in the future by abandoning the possession and restoring, or offering to restore, it to the lessor.

The courts in this state, from an early day, commencing as far back as the *Utica Insurance Cases*, have sought to regulate and restrict the defense of ultra vires so as to make it consistent with the obligations of justice. *Insurance Co. v. Scott*, 19 Johns. 1; *Curtis v. Leavitt*,

15 N. Y. 9; *Bissell v. Railroad Cos.*, 22 N. Y. 260, opinion of Comstock, C. J.; *Parish v. Wheeler*, Id. 495; *Arms Co. v. Barlow*, 63 N. Y. 62, 20 Am. Rep. 504; *Pratt v. Short*, 79 N. Y. 437, 35 Am. Rep. 531; *Woodruff v. Railway Co.*, 93 N. Y. 609; *Starin v. Edson*, 112 N. Y. 206, 19 N. E. 670. The case of *Woodruff v. Railway Co.*, supra, is very much in point in the present controversy. It was there held that the lessee of a railroad could not resist the payment of rent which accrued during its occupation under the lease on the ground that the lessor's title was derived under an ultra vires transaction. Our conclusion, therefore, is that the main question was properly decided against the defendant. It is said, however, that the contract was a Maine contract, and that by the law of that state the lease was illegal and void, and no action could be maintained upon it. It is a sufficient answer to this claim that the law of Maine on the subject does not appear by the record, and that it is the duty of this court, therefore, to determine the case according to the law of New York as established, or, in the absence of controlling authority, as justice having regard to all interests may seem to the court to require.

The question as to the liability of the defendant for the taxes assessed in 1890 was, we think, correctly adjudged. Finding no error in the record, the judgment should be affirmed.

VANN, J., dissented.

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### APPLETON v. CITIZENS' CENT. NAT. BANK.

(Court of Appeals of New York, 1908. 190 N. Y. 417, 83 N. E. 470, 32 L. R. A. [N. S.] 543.)

Appeal from Supreme Court, Appellate Division, First Department.

Action by R. Ross Appleton, as receiver of the Cooper Exchange Bank, against the Citizens' Central National Bank of New York. Appeal by plaintiff from a judgment affirming an order sustaining a demurrer to the complaint (119 App. Div. 889, 105 N. Y. Supp. 1105). Reversed. Judgment rendered on the demurrer, with leave to the defendant to withdraw the demurrer and serve an answer on payment of costs.

CULLEN, C. J. This action is brought by the plaintiff as receiver of a dissolved bank against the defendant, who is the successor of the Central National Bank of the city of New York. The complaint, which thus far has been held not to state a good cause of action, alleges: That on the 4th day of January, 1904, the bank which the plaintiff represents loaned and advanced to one Mikael Samuels the sum of \$12,000 on the written agreement of said Samuels to repay said sum on or before four months after date, with interest; the repayment of which said loan the Central National Bank guaranteed by the following instrument: "For and in consideration of \$1 and other



good and valuable considerations, the Central National Bank of the City of New York hereby guarantees to the Cooper Exchange Bank the payment at maturity of a loan of \$12,000, made this day to Mikael Samuels & Co. by the Cooper Exchange Bank." That at the time of said loan said Samuels was indebted to said Central Bank in the sum of \$10,000. That said loan was obtained by said Samuels, and guaranteed by said Central Bank, for the purpose, and upon the agreement, that the said Central Bank should receive out of said loan the sum of said \$10,000 which Samuels owed to it, which said sum said Central Bank did receive from Samuels. That Samuels failed to pay said loan except the sum of \$1,000. Judgment is demanded for the remaining sum of \$11,000, and interest. The Appellate Division decided the case by a divided court on the authority of a decision on a previous appeal. The complaint now before us is an amended one, and the record does not contain the original complaint. Consequently we are not informed as to what difference exists between the allegations of the two pleadings.

The plaintiff has been defeated on the theory that the execution of the guaranty by the defendant bank was *ultra vires*, and not binding upon it, and upon this ground the judgments below are sought to be sustained. Had the guaranty been limited to the amount which the bank, under its agreement with Samuels, was to receive out of the loan, we should be entirely clear that it was within the legitimate powers of the bank under the decisions of the Supreme Court of the United States in *People's Bank v. National Bank*, 101 U. S. 181, 25 L. Ed. 907, and *Cochran v. United States*, 157 U. S. 286, 15 Sup. Ct. 628, 39 L. Ed. 704. It was there held that a contract of guaranty of paper held by it was within the implied powers of a national bank, and this though, as in the later of the cases cited, the note was not made to the guaranteeing bank, but directly to the order of another bank to which the guaranty was made. We think, however, that the defendant's power to guarantee was limited by the extent of its interest in the subject-matter of the guaranty. To allow a bank to guarantee the payment by one of its debtors of a larger sum in order that the bank might receive or retrieve a lesser sum would be to permit it to enter upon very hazardous speculation, and authorize very wild and unsafe banking.

The learned counsel for the appellant frankly conceded on the argument that a recovery should be limited to the amount received by the defendant. It is insisted, however, that the contract of guaranty must be deemed either good or bad as an entirety, and cannot be upheld in part and rejected in part. I am not willing to concede this claim; but it is unnecessary to discuss it, for its determination is not necessary to the decision of the case. We may assume that the contract was *ultra vires*. We may further assume that in transactions by national banks we should adopt the law of *ultra vires* as it pre-

vails in the federal courts, and not the local law on the subject. Yet the defendant, in our opinion, became plainly liable for the amount which it received under the ultra vires contract. The law which obtains in this state and in several other jurisdictions is that, where one party has received the full benefit of an ultra vires contract, he cannot plead the invalidity of the contract to defeat an action upon it by the other party. *Bath Gas Light Co. v. Claffy*, 151 N. Y. 24, 45 N. E. 390, 36 L. R. A. 664.

A contrary rule obtains in the Supreme Court of the United States. There it is held that the execution of an ultra vires contract by one party cannot confer upon it validity or authorize the other party to sue on its obligations (*Central Transportation Company v. Pullman Palace Car Co.*, 139 U. S. 24, 11 Sup. Ct. 478, 35 L. Ed. 55); but at the same time it is also held that a party cannot retain money or property received by it under an ultra vires contract when it refuses to perform that contract (*Logan County Bank v. Townsend*, 139 U. S. 67, 11 Sup. Ct. 496, 35 L. Ed. 107). It was there said by Judge Harlan: "The bank, in this case insisting that it obtained the bonds of the plaintiff in violation of the act of Congress, is bound, upon being made whole, to return them to him. No exemption or immunity from this principle of right and duty is given by the national banking act. 'The obligation to do justice,' this court said in *Marsh v. Fulton County*, 10 Wall. (U. S.) 676, 684, 19 L. Ed. 1040, 'rests upon all persons, natural and artificial, and if a county obtains the money or property of others without authority, the law, independently of any statute, will compel restitution or compensation.'"

In a great many cases the difference between the law prevailing in the federal courts and that in our own would lead to great difference in results. In this case, however, as the plaintiff disclaims any right to recover beyond the amount actually received by the defendant, the result is exactly the same whether we adopt one rule or the other. Whatever the difference of view there may be as to the effect of ultra vires on corporate contracts, in no jurisdiction can a party retain what it has received under such a contract, and refuse to perform the contract.

It is urged by the counsel for the respondent that payment by its debtor of the claim it held against him constituted no consideration for the guaranty, for the debtor was bound to perform his obligation. There is no force in this suggestion. The money the defendant received was not that of Samuels, but the plaintiff's and Samuels was merely the conduit through which it was paid to the defendant. It is not a question of consideration between Samuels and the plaintiff, but of consideration between the plaintiff and the defendant. The plaintiff parted with its money solely on the guaranty of the defendant. Whoever heard that the loan of money to the principal was not sufficient consideration for the obligation of the surety? In this case

it was the surety who got the money. Nor is there any force in the suggestion that this action is not brought in disaffirmance of the contract for money had and received, but on the contract of guaranty. All the facts are set forth in the complaint, and if these facts entitle the plaintiff to relief on any theory, then the complaint states a good cause of action.

The judgments of the Appellate Division and Special Term should be reversed, and judgment rendered for plaintiff on demurrer, with costs in all the courts, with leave, however, to the defendant, within 20 days, to withdraw demurrer and serve answer upon the payment of such costs.

GRAY, HAIGHT, WERNER, WILLARD BARTLETT, and HISCOCK, JJ., concur. EDWARD T. BARTLETT, J., taking no part.

Judgment accordingly.

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### CITIZENS' CENT. NAT. BANK v. APPLETON.

(Supreme Court of United States, 1910. 216 U. S. 196, 30 Sup. Ct. 364, 54 L. Ed. 443.)

In error to the Supreme Court of the State of New York in and for the County of New York, to review a judgment entered pursuant to the mandate of the Court of Appeals of that state, which had reversed a judgment of the Appellate Division of the Supreme Court, First Department, affirming a judgment of the Supreme Court at Special Term, which dismissed, on demurrer, an action to recover from a national bank a sum of money received by it out of the proceeds of a loan made by another bank to a debtor of the defendant bank, at its request, and upon its guaranty. Affirmed.

See same case below, in court of appeals, 190 N. Y. 417, 83 N. E. 470, 32 L. R. A. (N. S.) 543, in supreme court, 116 App. Div. 404, 101 N. Y. Supp. 1027.

Mr. JUSTICE HARLAN delivered the opinion of the court.<sup>16</sup> \* \* \* The court of appeals of New York—Cullen, Ch. J., delivering the opinion—held and the counsel for the Cooper Exchange Bank conceded in that court, that no recovery could be had against the guaranteeing bank in excess of the amount actually received by it out of the \$12,000 loaned, as above stated. 190 N. Y. 417, 83 N. E. 470, 32 L. R. A. (N. S.) 543. The case being remitted to the inferior state court, judgment was therefor rendered against the defendant only for \$10,000, with interest from January 4th, 1904, with costs in all courts.

The plaintiff in error insists that the guaranty given by the Central National Bank to the Cooper Exchange Bank was beyond its power, was in violation of the national banking act, and, therefore, could not

<sup>16</sup> A portion of the opinion is omitted.



be made the foundation of an action against the guarantor bank. But this action need not be regarded as one on the written contract of guaranty, but as based on an implied contract between the Cooper Exchange Bank and the Central National Bank, whereby the latter, under the circumstances disclosed by the record, came under a duty to account to the former for the \$10,000 of the \$12,000 actually paid to Samuels at its request and on its guaranty. The law would be very impotent to do justice if it could not, under those circumstances, and without violating established legal principles, compel the Central National Bank to recognize and discharge that duty. Samuels owed the Central National Bank \$10,000, and—with knowledge, perhaps, of his financial condition—he was put forward by that bank to obtain \$12,000 from the Cooper Exchange Bank, so that it could get \$10,000 out of that sum, for its own use.

The circumstances show that the latter bank would not have loaned the money to Samuels except at the request and on the guaranty of the Central National Bank. All this, it may be observed, occurred under a previous agreement between the Central National Bank and Samuels, that that bank was to have \$10,000 of the \$12,000 in discharge of its claim upon him. In short, the Central National Bank, by means of the device mentioned, got \$10,000 of the money of the Cooper Exchange Bank for its own use, and having used it for its own benefit, it now seeks to avoid liability therefor, upon the ground that it was not allowed by the law of its creation to execute the guaranty in question. We know of no adjudged case that stands in the way of relief being granted as asked by the plaintiff. But there are many that will authorize such relief. \* \* \*

These views are supported by many other adjudged cases. In *Central Transp. Co. v. Pullman's Palace Car Co.*, 139 U. S. 24, 60, 11 Sup. Ct. 478, 35 L. Ed. 55, 68, the court, speaking by Mr. Justice Gray, said: "A contract ultra vires being unlawful and void, not because it is in itself immoral, but because the corporation, by the law of its creation, is incapable of making it, the courts, while refusing to maintain any action upon the unlawful contract, have always striven to do justice between the parties, so far as could be done consistently with adherence to law, by permitting property or money, parted with on the faith of the unlawful contract, to be recovered back, or compensation to be made for it. In such case, however, the action is not maintained upon the unlawful contract, nor according to its terms, but on an implied contract of the defendant to return, or, failing to do that, to make compensation for, property or money which it has no right to retain. To maintain such an action is not to affirm, but to disaffirm, the unlawful contract." So, in *Pullman's Car Co. v. Central Transp. Co.*, 171 U. S. 138, 151, 43 L. Ed. 108, 114, 18 Sup. Ct. 808, the court, speaking by Mr. Justice Peckham, said: "The right to a recovery of the property transferred under an illegal contract is found-

ed upon the implied promise to return or to make compensation for it." Other cases are cited in the margin.†

We need not go farther. It is entirely clear that the judgment against the defendant bank—which came into the possession of the property, and was subject to the liabilities, of the Central National Bank—was consistent with sound legal principles and was intrinsically right, even if the guaranty in question was beyond the power of the guaranteeing bank, under the national banking statutes. Whatever may be said as to the validity of the written guaranty, now alleged to be illegal, the judgment can be supported as based wholly on the implied contract, which made it the duty of the Central National Bank, under the facts disclosed, to account to the Cooper Exchange Bank for the money obtained from the latter in execution of the agreement made by the former with the borrower.

The judgment must be affirmed. It is so ordered.

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## XI. Liability for Torts<sup>17</sup>

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### KHARAS v. BARRON C. COLLIER, Inc.

(Supreme Court of New York, Appellate Division, First Department, 1916.  
171 App. Div. 388, 157 N. Y. Supp. 410.)

Appeal from Trial Term, New York County.

Action by Theodore Kharas against Barron C. Collier, Incorporated. From a judgment dismissing the complaint on plaintiff's opening, he appeals. Reversed, and new trial ordered.

PAGE, J. This is an action to recover damages for slander. The words spoken of plaintiff were undoubtedly actionable per se. The learned justice at Trial Term dismissed the complaint, on the ground that an action for slander could not be maintained against a corporation, upon the authority of *Eichner v. Bowery Bank*, 24 App. Div. 63, 48 N. Y. Supp. 978, a decision of this department. That action was brought to recover damages for the nonpayment of a check and for slander in stating, when the payment was refused, that the check was no good. The court said (Williams, J., writing): "So far as the

† *Merchants' Nat. Bank v. State Nat. Bank*, 10 Wall. 604, 644, 19 L. Ed. 1008, 1018; *United States v. State Nat. Bank*, 96 U. S. 30, 36, 24 L. Ed. 647, 648; *Louisiana v. Wood*, 102 U. S. 294, 26 L. Ed. 153; *Parkersburg v. Brown*, 106 U. S. 487, 503, 27 L. Ed. 238, 245, 1 Sup. Ct. 442; *Logan County Nat. Bank v. Townsend*, 139 U. S. 67, 74, 78, 35 L. Ed. 107, 110, 112, 11 Sup. Ct. 496; *Ditty v. Dominion Nat. Bank*, 22 C. C. A. 376, 43 U. S. App. 613, 615, 75 Fed. 769; *Atlantic Cotton Mills v. Indian Orchard Mills*, 147 Mass. 268, 9 Am. St. Rep. 698, 17 N. E. 496; *Perkins v. Boothby*, 71 Me. 94, 97; *Bank of Lakin v. National Bank*, 57 Kan. 183, 45 Pac. 587.

<sup>17</sup> For discussion of principles, see Clark on Corp. (3d Ed.) § 69.

action may be regarded as one to recover damages for slander of the plaintiff in his occupation of merchant or trader, it cannot be maintained against the defendant as a corporation. The theory of the plaintiff is that the defendant not only refused to pay the check, but that it also stated in effect that the plaintiff had no funds in the bank subject to the payment of the check. If this may be regarded as a slander at all, it was not one for which the corporation itself would be liable. The corporation itself could not talk. The statement must have been made by some officer or agent of the corporation, and if there was liability for slander at all it must have been the personal liability of such officer or agent, and not of the corporation."

As authority for this statement of the law, the court cites two text books. The quotation from Odger on Libel and Slander is from an early edition. The statement is entirely omitted from the later editions. The citation from Townshend (section 265) is as follows: "A corporation can act only by or through its officers or agents, and as there can be no agency to slander, it follows that a corporation cannot be guilty of slander. It has not capacity for committing that wrong. If an officer or an agent of a corporation is guilty of slander, he is personally liable, and no liability results to the corporation."

It would thus appear that the decision of this court in *Eichner v. Bowery Bank*, *supra*, was based upon the archaic doctrine that a corporation was an artificial being, invisible, intangible, and existing only in the contemplation of the law. Having no physical powers, it could not act; having no mind, it could not form an intent; having no mouth, it could not speak; and therefore those who acted, schemed, devised, or spoke for it were responsible, and not the intangible being in whose business they were engaged. This doctrine has long since been repudiated by the courts. In 1865 our Court of Appeals said: "Another important legal proposition in the case is so clear upon principle, and so distinctly settled by authority, that nothing but confusion can flow from its discussion. It will bear no more than plain enunciation. A corporation is liable to the same extent and under the same circumstances as a natural person for the consequences of its wrongful acts, and will be held to respond in a civil action at the suit of an injured party for every grade and description of forcible, malicious, or negligent tort or wrong it commits, however foreign to its nature or beyond its granted powers the wrongful transaction or act may be."  
\* \* \* A corporation aggregate being an artificial body—an imaginary person of the law, so to speak—is, from its nature, incapable of doing any act except through agents to whom is given by its fundamental law, or in pursuance of it, every power of action it is capable of possessing or exercising. Hence the rule has been established, and may now also be stated as an indisputable principle, that a corporation is responsible for the acts or negligence of its agents while engaged in the business of the agency, to the same extent and under the same circumstances that a natural person is chargeable with the acts or



negligence of his agents." *N. Y. & N. H. R. Co. v. Schuyler*, 34 N. Y. 30, 49, 50.

This principle has been repeatedly recognized, and a corporation held liable for tortious acts of its servants, even where a malicious and evil intent must be present as an element of the cause of action. A citation of authorities is unnecessary, but a multitude of cases will be found where corporations have been held liable for false representations, libels, and assault. This court has held that a corporation may be indicted and convicted of criminal libel. *People v. Star Co.*, 135 App. Div. 517, 120 N. Y. Supp. 498. The Court of Appeals has recently held that a corporation could not be guilty of manslaughter, but pointed out that such a result followed from the statutory definition of homicide, and not because a corporation could not be charged criminally with the unlawful purposes and motives of its agents, saying: "A corporation, generally speaking, is liable in civil proceedings for the conduct of the agents through whom it conducts its business, so long as they act within the scope of their authority, real or apparent; and it is but a step further in the same direction to hold that in many instances it may be charged criminally with the unlawful purposes and motives of such agents while so acting in its behalf." *People v. Rochester Ry. & L. Co.*, 195 N. Y. 102, 105, 88 N. E. 22, 23, 21 L. R. A. (N. S.) 998, 133 Am. St. Rep. 770, 16 Ann. Cas. 837.

The question whether a corporation could be sued for slander does not seem to have been presented to our courts since the case of *Eichner v. Bowery Bank*, supra, was decided. It has, however, been before the courts of other states, and it has uniformly, so far as I am advised, been held that the corporation was liable. *Fensky v. Maryland Casualty Co.*, 264 Mo. 154, 174 S. W. 416; *Comerford v. West End Ry. Co.*, 164 Mass. 13, 14, 41 N. E. 59; *Empire Cream Co. v. De Laval Dairy Co.*, 75 N. J. Law, 207, 67 Atl. 711; *Rivers v. Yazoo & M. V. R. Co.*, 90 Miss. 196, 43 South. 471, 9 L. R. A. (N. S.) 931; *Hussey v. Norfolk, etc., R. Co.*, 98 N. C. 34, 3 S. E. 923, 2 Am. St. Rep. 312; *Hypes v. So. Ry. Co.*, 82 S. C. 317, 64 S. E. 395, 21 L. R. A. (N. S.) 873, 17 Ann. Cas. 620. The latest text-books state the rule as well settled. 5 *Thomp. on Corp.* (2d Ed.) § 5441; 1 *Clark & Marshall, Priv. Corp.* p. 627 et seq.; *Newell on Slander and Libel* (3d Ed.) p. 436. The true rule, in my opinion, is that a corporation is liable for torts committed by its officers or agents when acting within the actual or implied scope of their employment, or by ratification may become responsible for such acts when committed in excess of their authority. Within the content of this rule a corporation may be held liable for a slander. The case of *Eichner v. Bowery Bank*, supra, holding the contrary, should be overruled.

The sufficiency of the allegations of the complaint was questioned at Trial Term, and it is urged here that the complaint is defective, in that it is not therein alleged that a duly authorized agent of the corporation uttered the defamatory words, nor does it allege that the

corporation in any manner authorized, ratified, or instigated the speaking of the slanderous words. The learned counsel for defendant overlooks the rule that the ultimate facts are to be pleaded, and not the evidence that would tend to substantiate those facts.

The plaintiff properly alleged the words were spoken by the defendant. As a corporation can only speak through some person or persons in its employ, the legal inference is that some such person or persons spoke for it. It is a matter of proof on the trial to establish that the person who spoke the words was acting within the scope of his employment, or that the corporation, by ratification of the act of speaking, had adopted and made the words its own.

The judgment will be reversed, and a new trial granted, with costs to appellant to abide event. Order filed. All concur.

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### HOBOKEN PRINTING & PUBLISHING CO. v. KAHN.

(Court of Errors and Appeals of New Jersey, 1896. 59 N. J. Law, 218, 35 Atl. 1053, 59 Am. St. Rep. 585.)

Error to supreme court.

Action by Gustav Kahn against the Hoboken Printing & Publishing Company. Judgment for plaintiff. Defendant brings error. Affirmed.

MAGIE, J. The writ of error in this case brings here the record of a judgment obtained by Kahn, the defendant in error, against the Hoboken Printing & Publishing Company, the plaintiff in error, in an action for libel. A previous judgment in Kahn's favor was reversed in this court, on account of the exclusion of evidence which a majority of the judges thought should have been admitted. *Publishing Co. v. Kahn*, 58 N. J. Law, 359, 33 Atl. 382, 1060, 55 Am. St. Rep. 609. A venire de novo having issued, Kahn obtained another verdict against the company, on which the judgment now before us was entered.

The assignments of error are directed to the conduct of the trial, and the first error alleged is that the trial judge refused to nonsuit Kahn at the close of his case. The bill of exceptions shows that the motion to nonsuit was put on two grounds: (1) That no damages had been proven; and (2) that it had not been shown that anybody had seen the printed articles which Kahn had put in evidence besides himself.

The first article put in evidence was that on which the declaration was founded, which reads as follows: "Gone with the Boodle. Gustav Kahn, who was employed as ticket taker at one of the entrances at the Eldorado, is among the missing. So is about two hundred (\$200) dollars of the gate receipts which were taken in Monday night. Detective Woods is looking for the festive Kahn, but up to date he can't be found. Kahn is said to be sequestering himself over on Long Island. Surely the Eldorado is having trouble upon trouble."

The second article put in evidence reads as follows: "Mr. Kahn

Denies. A Story of Which Detective Woods is the Author. Gus Kahn is the assistant manager at the Eldorado, and says he is not, and never has been, ticket taker. A statement was published on Wednesday to the effect that, on Monday night, about two hundred (\$200) dollars of the gate receipts at the Eldorado was missing, and that Detective Woods was looking for Mr. Kahn, who, it is alleged, had gone to Long Island. Mr. Kahn called to-day at the Observer office, and said there was absolutely no truth whatever in the story. He added that no money was missing, and that he has been at no time ticket taker. The information in the matter was given to a reporter by Detective Woods. Detective John Woods, when seen to-day by an Observer reporter, said that he and Detective Clifford had heard from numerous persons the report that Kahn has skipped with the receipts. Detective Woods said, also, that he and Detective Clifford had made an investigation, and a considerable number of the employes informed them that they also had heard the story about Kahn's sudden disappearance, and that money had gone with him. An officer of the park is willing to swear that he found the office, which Kahn had charge of, open after the park closed. It was common rumor that Kahn had gone off with the 'hoodle.' An usher said, in the presence of an Observer reporter and the two detectives, that he could not expect to get his pay now, as Kahn had gone off with the cash."

As the first article plainly imputed to Kahn conduct which was dishonest, fraudulent, and even criminal, evidence of any special damage was wholly unnecessary. Unless shown to be true, and to have been published for the ends and motives described in our constitutional provision on the subject, the publication of the article clearly entitled Kahn to recover damages. There was, therefore, no reason to nonsuit on the ground first alleged. In respect to the second ground relied on for a nonsuit, the bill of exceptions shows that it was afterwards disclosed by the evidence that the Observer, in which the articles in question had been published, was a newspaper printed and circulating in the city of Hoboken, from which the jury might well infer that they were seen by others who read that newspaper. Where the ground for nonsuit is a defect in evidence which is afterwards supplied, it is well settled that no reversal should follow.

The second assignment of errors is based upon an exception to a portion of the charge of the trial judge, covering a page and a half of the printed case, and containing three distinct and disconnected propositions. This exception is so general that it is doubtful whether a reviewing court ought to consider the single point on which it is now argued that there was error. But that point is raised under the next assignment of errors.

The third assignment of errors is based on an exception taken to the refusal of the trial judge to charge, as requested, that the jury could not give punitive, but only compensatory, damages. That damages



such as are called "punitive," or "vindictive," or "exemplary," may be awarded in actions of libel is a doctrine established by a long line of decisions. Mr. Addison says that wherever injury has been done to the fair fame, reputation, or character of the plaintiff, juries are generally invited to give, and are justified in giving, such a sum as marks their sense of the maliciousness or recklessness of the wrongdoer in offering the insult and injury, their belief in the groundlessness of the charge, and their desire to vindicate the character of the plaintiff. Add. Torts, 993. I do not understand that the counsel for the company in this case challenges this doctrine. His contention rather is that there is nothing in the evidence to justify the award of exemplary damages. Nor does he deny the liability of a corporation to an action for libel, which was settled by this court in *Association v. McDermott*, 44 N. J. Law, 430; nor that a corporation engaged in the business of publishing a newspaper will be responsible for damages done to reputation by articles published therein by agents employed for that purpose. But the claim is that exemplary damages may not be awarded in such a case unless the corporation approves and adopts the act of its agents in making such publication, and in support of this claim reliance is put upon the doctrine laid down by the supreme court in *Haines v. Schultz*, 50 N. J. Law, 481, 14 Atl. 488. It appeared in that case that the proprietor of a newspaper in which a libelous article was published was ignorant of its publication until after it had appeared. It was held that he would not be liable to punitive damages for a publication, made without his knowledge or consent, except upon proof of his subsequent approval of such publication. But it is unnecessary to determine whether the doctrine of that case is sound. A corporation engaged in publishing a newspaper obviously must act by selected agents. Its directors or managers cannot formally pass on each publication, or determine what is to be admitted therein. Such determination is necessarily committed to its agents. In making such determination, they are acting within the scope of their employment. The intent with which they publish must be imputed to the corporation which employs them to make the publications of the newspaper. If the intent is malicious, the corporation must be liable therefor, as it is for other tortious acts of its agents, done within the scope of their authority, and for the purposes for which the corporation was created and the agents were employed. *Gillett v. Railroad Co.*, 55 Mo. 315, 17 Am. Rep. 653; *Samuels v. Association*, 75 N. Y. 604, approving the dissenting opinion of Davis, P. J., in *Id.*, 9 Hun (N. Y.) 288; *Johnson v. Dispatch Co.*, 2 Mo. App. 565; *Hewitt v. Press Co.*, 23 Minn. 178, 23 Am. Rep. 680.

Now, the proof disclosed by the bill of exceptions was that the article upon which the action was brought was written by a reporter, and that it appeared in the paper with the headline, "Gone with the Boodle"; that Kahn, the day following its publication, demanded of the managing or city editor a retraction of the charge against him; and that the second article thereafter appeared. From this there was a

plainly justifiable inference, to wit, that the article sued upon was received, edited, and published by some agent of the company intrusted with that duty, and that the second article emanated from and was published by some one having that power conferred upon him by the company. Upon that inference being drawn, the liability of the company is precisely the same as that which an individual would incur by publishing such articles. Looking, then, at the first article, which charges Kahn with fraudulent and criminal conduct (a charge which the company did not pretend to justify), I think it obvious, not only that its language indicated what the law calls "malice,"—i. e. absence of lawful excuse (Odgers, Sland. & L. \*265),—but that its publication in a public newspaper indicated such a wanton and reckless disregard of Kahn's right to an unchallenged reputation that the jury might have been instructed to consider whether an increase of damages beyond those which would merely compensate him, and which would be sufficient to rebuke the malicious and reckless wrongdoer, and vindicate Kahn's character, ought not to be awarded. But, clearly, such an instruction was proper when the second article is considered. This was admissible in evidence under the doctrine laid down in this court in *Association v. McDermott*, supra. That it might be construed as a covert and evasive reiteration of the original charge is plain. If so, there was evidence in it of express malice and ill-will, which justified a refusal to instruct the jury that no damages of a punitive or exemplary character could be allowed. The result is that the judgment must be affirmed.

DIXON, J., dissented.<sup>18</sup>

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## XII. Responsibility for Crime<sup>19</sup>

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### COMMONWEALTH v. ILLINOIS CENT. R. CO.

(Court of Appeals of Kentucky, 1913. 152 Ky. 320, 153 S. W. 459, 45 L. R. A. [N. S.] 344, Ann. Cas. 1915B, 617.)

Appeal from Circuit Court, Hickman County.

The Illinois Central Railroad Company was accused of involuntary manslaughter, and from a judgment sustaining a demurrer to the indictment the Commonwealth appeals. Affirmed.

SETTLE, J. The appellee, Illinois Central Railroad Company, was indicted in the court below for the crime of involuntary manslaughter, committed, as, in substance, alleged, by its servants in charge of an engine and cars, which they unlawfully and with gross and willful

<sup>18</sup> Dissenting opinion omitted.

<sup>19</sup> For discussion of principles, see Clark on Corp. (3d Ed.) §§ 70-72.

negligence ran at unreasonable speed into another of appellee's cars, in which John Benedict was a passenger, whereby the latter was killed.

The circuit court sustained a demurrer to and dismissed the indictment, and from the judgment manifesting those rulings the commonwealth has appealed.

The question presented for decision by the appeal, is: Will an indictment lie against a corporation, such as a railroad company, for involuntary manslaughter? The rule, as announced in the text-books and by the decisions, is that a corporation cannot, in general, be indicted for ordinary crimes and misdemeanors that involve a criminal or immoral intent, such as are often grouped in books of the common law under the threefold designation of treason, felony, or breach of the peace. There has been no departure from the above rule in this jurisdiction. We have, it is true, held that a corporation is liable to indictment whenever the offense consists either in a misfeasance or a nonfeasance of duties to the public, and the corporation can be reached for punishment as by a fine and the seizure of its property; and that if the penalty prescribed for the offense be both fine and imprisonment the statute is inoperative as to the imprisonment, as that part of the punishment cannot, from the nature of the offender, be carried out. *Commonwealth v. Pulaski County A. & M. Ass'n*, 92 Ky. 197, 17 S. W. 442, 13 Ky. Law Rep. 468.

In the case, *supra*, the defendant corporation, a fair association, was indicted for permitting gaming on its grounds. A demurrer was sustained to the indictment, on the ground that, being a corporation, the defendant could not commit the offense. In rejecting that doctrine the court, in the opinion, following a statement of the common law on this subject, said: "Experience showed the necessity of modifying the old rules, and the decided tendency of modern decision has been to extend the application of all legal remedies, both civil and criminal, to corporations, and subject them thereto as in the case of individuals, so far as is possible. It is therefore well settled in the courts of this country, as well as in England, that they are indictable for misfeasance as well as a nonfeasance of duty unlawful in itself and injurious to the public. It has therefore been held that they may be indicted for a nuisance, whether arising from misfeasance or nonfeasance, or for an injury otherwise to the public, unlawful in itself and arising either from commission or the omission to perform a legal duty. They may be indicted for erecting and continuing a building, for leaving railroad cars in the street, for neglecting to repair a highway, for permitting stagnant water to remain on their premises, for libel, for 'Sabbath breaking' by doing work on Sunday in violation of a statute, and in many other instances. It is true there are crimes of which, from their very nature, as perjury, for example, they cannot be guilty. There are crimes to the punishment for which, for a like reason, they cannot be subjected, as in the case of a felony;



but wherever the offense consists in either a misfeasance or a non-feasance of duty to the public, and the corporation can be reached for punishment, as by a fine and the seizure of its property, precedent authorizes and public policy requires that it should be liable to indictment."

While not mentioned in the opinion, *supra*, homicide, in any of its degrees, is not an offense for which a corporation may be indicted; at any rate, no court, so far as we are advised, has ever so decided.

An interesting discussion of the doctrine in question is contained in volume 5, §§ 5620 and 5621, Thompson on Corporations. In section 5621 it is, among other things, said: "Corporations cannot be indicted for offenses which derive their criminality from evil intention, or which consist in a violation of those social duties which appertain to men and subjects. They cannot be guilty of treason and felony; of perjury or offenses against the person. But beyond this there is no good reason for their exemption from the consequences of unlawful and wrongful acts committed by their agents in pursuance of authority derived from them. Such a rule would, in many cases, preclude all adequate remedy, and render reparation for an injury committed by a corporation, impossible, because it would leave the only means of redress to be sought against irresponsible servants, instead of against those who truly committed the wrongful act by commanding it to be done. There is no principle of law which would thus furnish immunity to the corporation. \* \* \* It is now settled beyond dispute in most jurisdictions that a corporation is responsible for the criminal acts or omissions of its officers or agents to the same extent that it is civilly liable for its torts; and the fact that it cannot be punished in all the ways that an individual offender may be punished does not affect the principle. Though a corporation is not subject to imprisonment, still it may be punished by a fine, and the fine may be enforced against its property, or it may have its charter forfeited for abuse."

In section 5621 it is also said: "The corporation cannot be prosecuted for a crime, where the punishment prescribed cannot be imposed upon a corporation. Thus a corporation cannot be indicted for a felony, because the punishment for felony is death or imprisonment. But if the penalty provides for fine or imprisonment, then the corporation may be indicted, because punishment by fine may be imposed for the offense. A corporation cannot, in the nature of things, be guilty of treason, felony, or perjury. So a corporation cannot be prosecuted for larceny, assault and battery, or homicide. But it has been held that a corporation, owner of a steam vessel, may be guilty of manslaughter under the federal statute, which provides that every owner of a vessel through whose misconduct, fraud, or violation of law lives are lost on such vessel, shall be deemed guilty of manslaughter, and upon conviction thereof shall be sentenced to confinement at hard labor, though it cannot be subjected to the punishment imposed;

and this fact has been held not to affect the right of the government to prosecute individuals under said statute, who aid and abet the corporation in the commission of a crime." 1 Bishop's New Criminal Law, §§ 417-419, 421, 422; 10 Cyc. 1231.

The crimes murder and manslaughter are not defined by statute in this state, though the punishment for the former and voluntary manslaughter is prescribed by statute, but both are defined by the common law and accepted by the courts of the state as thereby defined. Involuntary manslaughter, a lesser degree of manslaughter, is an offense at the common law for which no penalty is prescribed by statute in this state; consequently the punishment inflicted upon persons convicted in the state of involuntary manslaughter is that prescribed by the common law for the offense, viz., a fine in any amount, or imprisonment in jail any length of time, or both, in the discretion of the jury. *Brown v. Commonwealth*, 122 Ky. 626, 92 S. W. 542, 28 Ky. Law Rep. 1335; *Spriggs v. Commonwealth*, 113 Ky. 724, 68 S. W. 1087, 24 Ky. Law Rep. 540.

It is insisted for the commonwealth that, as involuntary manslaughter is but a misdemeanor, the commission of which does not require an intent, it is an offense for which a corporation may be indicted, and, if convicted, punished by a fine, although it could not be imprisoned in jail, if imprisonment were a part of or all the punishment inflicted by the verdict of the jury. This contention is, in our opinion, unsound for two reasons: First, because, however certain its civil liability therefor when committed by its servants in the apparent scope of their authority, a corporation cannot be criminally prosecuted for offenses against the person, such as assault and battery or homicide. Second, because involuntary manslaughter is homicide, and homicide is the killing of one human being by another human being.

Involuntary manslaughter is the killing by one person of another person in doing some unlawful act not amounting to a felony, nor likely to endanger life, and without an intention to kill, or where one kills another while doing a lawful act in an unlawful manner. *Robertson's Kentucky Criminal Law*, § 198; *Conner v. Commonwealth*, 13 Bush, 718; *Trimble v. Commonwealth*, 78 Ky. 177; *York v. Commonwealth*, 82 Ky. 368; *Westrup v. Commonwealth*, 123 Ky. 95, 93 S. W. 646, 29 Ky. Law Rep. 519, 6 L. R. A. (N. S.) 685, 124 Am. St. Rep. 316.

We are aware that section 457, Kentucky Statutes, declares that "the word 'person' may extend and be applied to bodies politic and corporate, societies, communities, and the public generally, as well as individuals, partnerships, persons and joint stock companies." But in a case of homicide, though it be involuntary manslaughter, it would, we think, be giving the word "person" a tortured meaning to say that it includes a corporation. The word "person" may include in its meaning a corporation, but it does not in all cases necessarily do so. Besides, as in homicide of whatever degree there must be a killing by one

person of another person, the word "another" can only mean another member of the same class as the slayer, and a corporation, though a "person" in law, is but an artificial person, and therefore not of the class to which the person slain belongs.

In *People v. Rochester R. & L. Co.*, 195 N. Y. 102, 88 N. E. 22, 21 L. R. A. (N. S.) 998, 133 Am. St. Rep. 770, 16 Ann. Cas. 837, the corporation, a railway and light company, was indicted for what is defined by section 193, New York Penal Code, as manslaughter in the second degree, which seems to be the identical offense known at the common law, and with us, as involuntary manslaughter. It was charged in the indictment that the corporation installed certain apparatus in a residence in Rochester in such a grossly improper, unskillful, and negligent manner that gases escaped and caused the death of an inmate. A demurrer to the indictment presented the question whether a corporation might be thus indicted for manslaughter under the laws of New York. The demurrer was sustained by the trial court, and a judgment to that effect, on appeal, affirmed. After citing and commenting upon numerous authorities, both English and American, on the question involved, the Court of Appeals concluded its opinion by setting forth the following reasons for its conclusion that the indictment would not lie:

"Within the principles thus and elsewhere declared, we have no doubt that a definition of certain forms of manslaughter might have been formulated which would be applicable to a corporation, and make it criminally liable for various acts of misfeasance and nonfeasance when resulting in death, and amongst which very probably might be included conduct in its substance similar to that here charged against the respondent. But, this being so, the question still confronts us whether corporations have been so made liable for the crime of manslaughter as now expressly defined in the section alone relied on by the people; and this question, we think, must be decisively answered in the negative. Section 179 of the Penal Code defines homicide as 'the killing of one human being by the act, procurement or omission of another.' We think that this final word 'another' naturally and clearly means a second or additional member of the same kind or class alone referred to by the preceding words, namely, another human being; and that we should not interpret it, as appellant asks us to, as meaning another 'person,' which might then include corporations. It seems to us that it would be a violent strain upon a criminal statute to construe this word as meaning an agency of some kind other than that already mentioned or referred to, and as bridging over a radical transition from human beings to corporations. Therefore we construe this definition of homicide as meaning the killing of one human being by another human being. Section 180 says that 'homicide is either: 1. Murder; 2. Manslaughter,' etc. Section 193 says that 'such homicide'—that is, 'the killing of one human being \* \* \* by another'—is manslaughter in the second degree, when committed 'without a



design to effect death. \* \* \* 3. By any act, procurement, or culpable negligence of any person, which \* \* \* does not constitute the crime of murder in the first or second degree, nor manslaughter in the first degree.' Thus we have the underlying and fundamental definition of homicide as the killing of one human being by another human being, and out of this basic act thus defined, and according to the circumstances which accompany it, are established crimes of varying degree, including that of manslaughter, for which the respondent has been indicted. In the definition of these crimes, as contained in the sections under consideration (183-193), we do not discover any evidence of an intent on the part of the Legislature to abandon the limitation of its enactments to human beings, or to include a corporation as a criminal. Many of these sections could not, by any possibility, apply to a corporation, and, in our opinion, subdivision 3 of section 193, relating to manslaughter, manifestly does not. It is true that the term 'person,' used therein, may, at times, include corporations, but that is not the case here. The surrounding and related sections are not calculated to induce the belief that it has any such meaning; and the classification of manslaughter as a form of homicide, and the definition of homicide, already quoted, forbid it. The judgment should be affirmed."

In *Commonwealth v. Punxsutawney Street Pass. R. Co.*, 24 Pa. Co. Ct. R. 25, in quashing an indictment for manslaughter, the court said: "That a corporation may be indicted for nonfeasance or misfeasance resulting in nuisance, and the like, is well settled; but we are not aware of any decision that has gone the length of holding that a corporation may be indicted for a crime involving the elements of personal violence and criminal intent, and none has been cited. It is liable civilly for the torts of its agents in the course of their employment, and, under certain circumstances, may be mulcted into exemplary damages. These damages only are allowed by way of punishment for a wrong committed, and in a measure answer the purposes of a fine imposed in a criminal case. As was suggested on the argument, some courts have shown a tendency to enlarge on the criminal liability of corporations, but no court has gone so far as we are urged to go in this case. Hence not a single case is to be found to sustain this indictment. We should make haste slowly when it is in the direction of holding either an individual or a corporation criminally responsible for a crime committed by an employé without his or its knowledge or consent. Moreover, the criminal act alleged here is so far ultra vires as to contravene all accepted rules in the criminal law for making it the act of the principal."

In *Reg. v. Great Western Laundry Company*, 3 Can. Crim. Cas. 514, where a corporation was indicted for manslaughter arising out of the death of an employé, alleged to have been caused by its unlawful failure to take reasonable precautions in respect to certain dangerous machinery left unguarded, the indictment seems to have been based

upon a statute providing that homicide is culpable when it consists in the killing of any person, either by an unlawful act or by an omission, without lawful excuse. It was held that, "although the statute was sufficiently broad to comprehend the corporation, a demurrer to the indictment was properly sustained, on the ground that a corporation cannot be made criminally liable for such acts as are spoken of as crimes in the more popular sense of the word; that is, crimes of which the essence is the personal criminal intent or malice, or negligence carried to an extent that it amounts to willfully incurring the risk of causing injury to others." Upon this point the court continued: "Whether, if a corporation can be held criminally liable, as it certainly can, for one class of cases resulting from negligence, it is illogical not to extend its criminal liability to manslaughter resulting from negligence is not for me to say; but, sitting as a trial judge, I cannot say that I have any doubt that, as the law stands at present, I cannot so extend it. On these grounds I would have to allow a demurrer; but there is the additional objection to it, which also, I think, would have to prevail, that a corporation cannot be punished for manslaughter."

We regard the foregoing authorities as conclusive of the instant case. While the tendency of the later cases is to extend the doctrine of corporate, civil liability for torts involving personal violence to criminal prosecutions, in most states in which that has been done, the indictments provided for are designed mainly to furnish a civil remedy in favor of the estate of the deceased, although in the form of a criminal action; therefore the decisions in those states are of little importance in determining the question before us.

Manifestly, a corporation cannot be indicted for a form of homicide, the only punishment for which is death or imprisonment; for, being an intangible thing, it cannot be subject to such penalties. But, as intimated by the learned commentator in a footnote to *People v. Rochester R. & L. Co.*, supra, as to the lesser degrees, at least those not involving actual intent, for which the penalty prescribed may be a fine, it would seem that an indictment might be made to lie, if authorized by a statute including corporations.

It is patent, however, that we have no such statute in this state; and the statute which provides that the word "person" may include a corporation makes of the corporation only an artificial person, incapable, without a legislative enactment to that effect, of committing a crime which the common law declares to be involuntary manslaughter.

In our view of the law the circuit court ruled correctly in sustaining the demurrer. Wherefore the judgment is affirmed.

## PEOPLE v. STAR CO.

(Supreme Court of New York, Appellate Division, First Department, 1909.  
135 App. Div. 517, 120 N. Y. Supp. 498.)

Appeal from Court of General Sessions, New York County.

The Star Company was convicted of criminal libel, and it appeals. Affirmed.

SCOTT, J. The defendant, a domestic corporation printing and publishing a daily newspaper, appeals from a judgment of conviction of the offense of criminal libel. Of the libelous character of the article complained of and its publication by defendant there can be no question. The defendant complains that its challenge to one of the jurors was improperly overruled, whereby it was compelled to resort to a peremptory challenge. The chief defect charged against the juror appears to be that he was too intelligent and conscientious. Notwithstanding this, he repeatedly said that he did not think that it would take any evidence to overcome any prejudice he might have against the newspaper published by defendant, that he did not think he would be influenced thereby, and that he believed that he could render a verdict upon the evidence alone, uninfluenced by any feeling. This was sufficient to qualify him as a juror, and the challenge was properly overruled. "It is sufficient under the statute now in force if the juror believes that his opinion will not influence his verdict, etc., and it is not essential that he should be positive upon the subject." *People v. Ham-partjoomian*, 196 N. Y. 77, 81 N. E. 451.

The defendant also criticises a sentence in the charge, which was possibly erroneous, or superfluous, because there was no evidence in the case to which it was applicable. But it was distinctly more favorable to the defendant than it was entitled to, and therefore furnishes no ground for reversal.

The defendant's chief contention, and the only one requiring extended consideration, is that, being a corporation, and having neither soul, conscience, mind, or feeling, it is incapable of entertaining a mischievous and malicious intent, which is an essential element in criminal libel. A criminal libel is defined by the Penal Code (under which defendant was indicted and tried) as a "malicious publication." Section 242. Section 244 of the same Code provides that: "A publication having the tendency or effect mentioned in section 242 is to be deemed malicious if no justification or excuse therefor is shown."

And section 718, subd. 3, provides that: "Each of the terms 'malice' and 'malicious' imports an evil intent, or wish, or design to vex, annoy or injure another person."

The Court of Appeals has very recently pointed out the development and evolution of the law respecting the punishment of corporations for crimes involving the element of intent. *People v. Rochester Ry. & Light Co.*, 195 N. Y. 102, 88 N. E. 22, 21 L. R. A. (N. S.) 998, 133 Am. St. Rep. 770, 16 Ann. Cas. 837. At one time it was generally con-



sidered that a corporation was incapable of committing a crime. By slow degrees, and following upon the extension of the practice of organizing corporations for the purpose of avoiding the penalties of illegal acts, the courts have reached a different conclusion, until the present rule has come to be recognized as that enunciated by Mr. Bishop in his *New Criminal Law* (section 417) as follows: "But within the sphere of its corporate capacity, and to an undefined extent beyond, whenever it assumes to act as a corporation, it has the same capabilities of criminal intent and of act—in other words, of crime—as an individual man sustaining to the thing the like relations. \* \* \* Some have stumbled on the seeming impossibility of the artificial and soulless being, called a corporation, having an evil mind or criminal intent. \* \* \* But the author explained in another work that, since a corporation acts by its officers and agents, their purposes, motives, and intent are just as much those of the corporation as are things done."

It was recently said by the Supreme Court of the United States: "It is true that there are some crimes, which in their nature cannot be committed by corporations. But there is a large class of offenses \* \* \* wherein the crime consists in purposely doing things prohibited by statute. In that class of crimes we see no good reason why corporations may not be held responsible for and charged with the knowledge and purpose of their agents, acting within the authority conferred upon them." *N. Y. Cen. & Hudson R. R. Co. v. United States*, 212 U. S. 481, 29 Sup. Ct. 304, 53 L. Ed. 613.

Nothing is more common than the rendition of verdicts for punitive damages in civil actions for libel, which implies a publication inspired by actual malice. It is true that such malice is often inferred from gross carelessness or other circumstances; but the inference must be that actual malice existed. Hence such verdicts are to be sustained only upon the presumption that the offending corporation was capable of entertaining and being charged with actual malice. So, also, the Supreme Court of Massachusetts, in holding that a corporation might be held guilty of a criminal contempt, said: "We think that a corporation may be liable criminally for certain offenses of which a specific intent may be a necessary element. There is no more difficulty in imputing to a corporation a specific intent in criminal proceedings than in civil." *Telegram News Co. v. Commonwealth*, 172 Mass. 294-297, 52 N. E. 445, 44 L. R. A. 159, 70 Am. St. Rep. 280. To the same effect is *United States v. MacAndrews & Forbes Co.* (C. C.) 149 Fed. 823.

We find no difficulty, therefore, in holding that a corporation may be indicted for and convicted of the crime of criminal libel; the evil intent of its agents who write and print the libel being attributable to it.

The judgment of conviction is affirmed. All concur.

chap 8

## THE CORPORATION AND THE STATE

### I. Power of the State Over Corporations—Charter as a Contract <sup>1</sup>

#### TRUSTEES OF DARTMOUTH COLLEGE v. WOODWARD.

(Supreme Court of the United States, 1819. 4 Wheat. 518, 4 L. Ed. 629.)

MARSHALL, C. J.<sup>2</sup> This is an action of trover, brought by the trustees of Dartmouth College against William H. Woodward, in the State Court of New Hampshire, for the books of records, corporate seal, and other corporate property, to which the plaintiffs allege themselves to be entitled.

A special verdict, after setting out the rights of the parties, finds for the defendant, if certain acts of the legislature of New Hampshire, passed on the 27th of June and on the 18th of December, 1816, be valid and binding on the trustees without their assent, and not repugnant to the constitution of the United States; otherwise, it finds for the plaintiffs.

The Superior Court of Judicature of New Hampshire rendered a judgment upon this verdict for the defendant, which judgment has been brought before this court by writ of error. The single question now to be considered is, do the acts to which the verdict refers violate the constitution of the United States?

This court can be insensible neither to the magnitude nor delicacy of this question. The validity of a legislative act is to be examined, and the opinion of the highest law tribunal of a state is to be revised; an opinion which carries with it intrinsic evidence of the diligence, of the ability and the integrity with which it was formed. On more than one occasion this court has expressed the cautious circumspection with which it approaches the consideration of such questions, and has declared that in no doubtful case would it pronounce a legislative act to be contrary to the constitution. But the American people have said, in the constitution of the United States, that "no state shall pass any bill of attainder, ex post facto law, or law impairing the obligation of contracts." In the same instrument they have also said "that the judicial power shall extend to all cases in law and equity arising under the constitution." On the judges of this court, then, is imposed the high and solemn duty of protecting, from even legislative violation, those contracts which the constitution of our country has placed beyond legisla-

<sup>1</sup> For discussion of principles, see Clark on Corp. (3d Ed.) §§ 73, 74.

<sup>2</sup> The statement of facts and opinions of Washington and Story, Justices, are omitted.

tive control, and, however irksome the task may be, this is a duty from which we dare not shrink.

The title of the plaintiffs originates in a charter dated the 13th day of December, in the year 1769, incorporating twelve persons therein mentioned, by the name of "The Trustees of Dartmouth College," granting to them and their successors the usual corporate privileges and powers, and authorizing the trustees, who are to govern the college, to fill up all vacancies which may be created in their own body.

The defendant claims under three acts of the legislature of New Hampshire, the most material of which was passed on the 27th of June, 1816, and is entitled "An act to amend the charter, and enlarge and improve the corporation of Dartmouth College." Among other alterations in the charter, this act increases the number of trustees to twenty-one, gives the appointment of the additional members to the executive of the state, and creates a board of overseers, with power to inspect and control the most important acts of the trustees. The board consists of twenty-five persons. The president of the senate, the speaker of the house of representatives, of New Hampshire, and the governor and lieutenant-governor of Vermont, for the time being, are to be members *ex-officio*. The board is to be completed by the governor and council of New Hampshire, who are also empowered to fill all vacancies which may occur. The acts of the 18th and 26th of December are supplemental to that of the 27th of June, and are principally intended to carry that act into effect.

The majority of the trustees of the college have refused to accept this amended charter, and have brought this suit for the corporate property, which is in possession of a person holding by virtue of the acts which have been stated.

It can require no argument to prove that the circumstances of this case constitute a contract. An application is made to the crown for a charter to incorporate a religious and literary institution. In the application it is stated that large contributions have been made for the object, which will be conferred on the corporation as soon as it shall be created. The charter is granted, and on its faith the property is conveyed. Surely in this transaction every ingredient of a complete and legitimate contract is to be found.

The points for consideration are :

1. Is this contract protected by the constitution of the United States?
2. Is it impaired by the acts under which the defendant holds?

1. On the first point it has been argued that the word "contract," in its broadest sense, would comprehend the political relations between the government and its citizens, would extend to offices held within a state for state purposes, and to many of those laws concerning civil institutions which must change with circumstances and be modified by ordinary legislation; which deeply concern the public, and which, to preserve good government, the public judgment must control; that



even marriage is a contract, and its obligations are affected by the laws respecting divorces; that the clause in the constitution, if construed in its greatest latitude, would prohibit these laws. Taken in its broad, unlimited sense, the clause would be an unprofitable and vexatious interference with the internal concerns of a state, would unnecessarily and unwisely embarrass its legislation, and render immutable those civil institutions which are established for purposes of internal government, and which, to subserve those purposes, ought to vary with varying circumstances. That as the framers of the constitution could never have intended to insert in that instrument a provision so unnecessary, so mischievous, and so repugnant to its general spirit, the term "contract" must be understood in a more limited sense. That it must be understood as intended to guard against a power of at least doubtful utility, the abuse of which had been extensively felt, and to restrain the legislature in future from violating the right to property. That anterior to the formation of the constitution a course of legislation had prevailed in many, if not in all, of the states, which weakened the confidence of man in man and embarrassed all transactions between individuals by dispensing with a faithful performance of engagements. To correct this mischief, by restraining the power which produced it, the state legislatures were forbidden "to pass any law impairing the obligation of contracts," that is, of contracts respecting property, under which some individual could claim a right to something beneficial to himself; and that, since the clause in the constitution must in construction receive some limitation, it may be confined, and ought to be confined, to cases of this description; to cases within the mischief it was intended to remedy.

The general correctness of these observations cannot be controverted. That the framers of the constitution did not intend to restrain the states in the regulation of their civil institutions, adopted for internal government, and that the instrument they have given us is not to be so construed, may be admitted. The provision of the constitution never has been understood to embrace other contracts than those which respect property, or some object of value, and confer rights which may be asserted in a court of justice. It never has been understood to restrict the general right of the legislature to legislate on the subject of divorces. Those acts enable some tribunals, not to impair a marriage contract, but to liberate one of the parties because it has been broken by the other. When any state legislature shall pass an act annulling all marriage contracts, or allowing either party to annul it without the consent of the other, it will be time enough to inquire whether such an act be constitutional.

The parties in this case differ less on general principles, less on the true construction of the constitution in the abstract, than on the application of those principles to this case, and on the true construction of the charter of 1769. This is the point on which the cause essentially depends. If the act of incorporation be a giant of political power, if

✓ it create a civil institution to be employed in the administration of the government, or if the funds of the college be public property, or if the state of New Hampshire, as a government, be alone interested in its transactions, the subject is one in which the legislature of the state may act according to its own judgment, unrestrained by any limitation of its power imposed by the constitution of the United States.

But if this be a private eleemosynary institution, endowed with a capacity to take property for objects unconnected with government, whose funds are bestowed by individuals on the faith of the charter; if the donors have stipulated for the future disposition and management of those funds in the manner prescribed by themselves, there may be more difficulty in the case, although neither the persons who have made these stipulations nor those for whose benefit they were made should be parties to the cause. Those who are no longer interested in the property may yet retain such an interest in the preservation of their own arrangements as to have a right to insist that those arrangements shall be held sacred. Or, if they have themselves disappeared, it becomes a subject of serious and anxious inquiry whether those whom they have legally empowered to represent them forever may not assert all the rights which they possessed while in being; whether, if they be without personal representatives who may feel injured by a violation of the compact, the trustees be not so completely their representatives, in the eye of the law, as to stand in their place, not only as respects the government of the college, but also as respects the maintenance of the college charter.

It becomes, then, the duty of the court most seriously to examine this charter, and to ascertain its true character.

From the instrument itself it appears that about the year 1754 the Rev. Eleazar Wheelock established, at his own expense and on his own estate, a charity school for the instruction of Indians in the Christian religion. The success of this institution inspired him with the design of soliciting contributions in England for carrying on and extending his undertaking. In this pious work he employed the Rev. Nathaniel Whitaker, who, by virtue of a power of attorney from Dr. Wheelock, appointed the Earl of Dartmouth and others trustees of the money which had been, and should be, contributed, which appointment Dr. Wheelock confirmed by a deed of trust authorizing the trustees to fix on a site for the college. They determined to establish the school on Connecticut river, in the western part of New Hampshire, that situation being supposed favorable for carrying on the original design among the Indians, and also for promoting learning among the English; and the proprietors in the neighborhood having made large offers of land on condition that the college should there be placed. Dr. Wheelock then applied to the crown for an act of incorporation, and represented the expediency of appointing those whom he had, by his last will, named as trustees in America, to be members of the proposed corporation. "In consideration of the premises," "for the education

and instruction of the youth of the Indian tribes," etc., "and also of English youth and any others," the charter was granted, and the trustees of Dartmouth College were by that name created a body corporate, with power, for the use of the said college, to acquire real and personal property, and to pay the president, tutors and other officers of the college such salaries as they shall allow.

The charter proceeds to appoint Eleazar Wheelock, "the founder of said college," president thereof, with power by his last will to appoint a successor, who is to continue in office until disapproved by the trustees. In case of vacancy the trustees may appoint a president, and in case of the ceasing of a president the senior professor or tutor, being one of the trustees, shall exercise the office until an appointment shall be made. The trustees have power to appoint and displace professors, tutors, and other officers, and to supply any vacancies which may be created in their own body by death, resignation, removal, or disability; and also to make orders, ordinances and laws for the government of the college, the same not being repugnant to the laws of Great Britain or of New Hampshire, and not excluding any person on account of his speculative sentiments in religion, or his being of a religious profession different from that of the trustees.

This charter was accepted, and the property, both real and personal, which had been contributed for the benefit of the college, was conveyed to, and vested in, the corporate body.

From this brief review of the most essential parts of the charter it is apparent that the funds of the college consisted entirely of private donations. It is, perhaps, not very important who were the donors. The probability is that the Earl of Dartmouth and the other trustees in England were, in fact, the largest contributors. Yet the legal conclusion from the facts recited in the charter would probably be that Dr. Wheelock was the founder of the college.

The origin of the institution was, undoubtedly, the Indian charity school established by Dr. Wheelock, at his own expense. It was at his instance, and to enlarge this school, that contributions were solicited in England. The person soliciting these contributions was his agent, and the trustees, who received the money, were appointed by, and act under, his authority. It is not too much to say that the funds were obtained by him, in trust, to be applied by him to the purposes of his enlarged school. The charter of incorporation was granted at his instance. The persons named by him in his last will, as the trustees of his charity school, compose a part of the corporation, and he is declared to be the founder of the college, and its president for life. Were the inquiry material, we should feel some hesitation in saying that Dr. Wheelock was not, in law, to be considered as the founder (1 Bl. Com. 481) of this institution, and as possessing all the rights appertaining to that character. But be this as it may, Dartmouth Col-



lege is really endowed by private individuals, who have bestowed their funds for the propagation of the Christian religion among the Indians, and for the promotion of piety and learning generally. From these funds the salaries of the tutors are drawn, and these salaries lessen the expense of education to the students. It is, then, an eleemosynary (1 Bl. Com. 471), and, so far as respects its funds, a private corporation.

Do its objects stamp on it a different character? Are the trustees and professors public officers, invested with any portion of political power, partaking in any degree in the administration of civil government, and performing duties which flow from the sovereign authority?

That education is an object of national concern, and a proper subject of legislation, all admit. That there may be an institution founded by government, and placed entirely under its immediate control, the officers of which would be public officers, amenable exclusively to government, none will deny. But is Dartmouth College such an institution? Is education altogether in the hands of government? Does every teacher of youth become a public officer, and do donations for the purpose of education necessarily become public property, so far that the will of the legislature, not the will of the donor, becomes the law of the donation? These questions are of serious moment to society, and deserve to be well considered.

Dr. Wheelock, as the keeper of his charity school, instructing the Indians in the art of reading, and in our holy religion, sustaining them at his own expense, and on the voluntary contributions of the charitable, could scarcely be considered as a public officer, exercising any portion of those duties which belong to government; nor could the legislature have supposed that his private funds, or those given by others, were subject to legislative management, because they were applied to the purposes of education. When, afterwards, his school was enlarged, and the liberal contributions made in England and in America enabled him to extend his cares to the education of the youth of his own country, no change was wrought in his own character or in the nature of his duties. Had he employed assistant tutors with the funds contributed by others, or had the trustees in England established a school with Dr. Wheelock at its head, and paid salaries to him and his assistants, they would still have been private tutors, and the fact that they were employed in the education of youth could not have converted them into public officers, concerned in the administration of public duties, or have given the legislature a right to interfere in the management of the fund. The trustees, in whose care that fund was placed by the contributors, would have been permitted to execute their trust uncontrolled by legislative authority.

Whence, then, can be derived the idea that Dartmouth College has become a public institution, and its trustees public officers, exercising powers conferred by the public for public objects? Not from the source whence its funds were drawn, for its foundation is purely pri-

vate and eleemosynary. Not from the application of those funds, for money may be given for education, and the persons receiving it do not, by being employed in the education of youth, become members of the civil government. Is it from the act of incorporation? Let this subject be considered.

A corporation is an artificial being, invisible, intangible, and existing only in contemplation of law. Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence. These are such as are supposed best calculated to effect the object for which it was created. Among the most important are immortality, and, if the expression may be allowed, individuality; properties by which a perpetual succession of many persons are considered as the same, and may act as a single individual. They enable a corporation to manage its own affairs, and to hold property without the perplexing intricacies, the hazardous and endless necessity, of perpetual conveyances for the purpose of transmitting it from hand to hand. It is chiefly for the purpose of clothing bodies of men, in succession, with these qualities and capacities that corporations were invented, and are in use. By these means a perpetual succession of individuals are capable of acting for the promotion of the particular object, like one immortal being. But this being does not share in the civil government of the country, unless that be the purpose for which it was created. Its immortality no more confers on it political power, or a political character, than immortality would confer such power or character on a natural person. It is no more a state instrument than a natural person exercising the same powers would be. If, then, a natural person, employed by individuals in the education of youth, for the government of a seminary in which youth is educated, would not become a public officer, or be considered as a member of the civil government, how is it that this artificial being, created by law for the purpose of being employed by the same individuals for the same purposes, should become a part of the civil government of the country? Is it because its existence, its capacities, its powers, are given by law? Because the government has given it the power to take and to hold property in a particular form, and for particular purposes, has the government a consequent right substantially to change that form, or to vary the purposes to which the property is to be applied? This principle has never been asserted or recognized, and is supported by no authority. Can it derive aid from reason?

The objects for which a corporation is created are universally such as the government wishes to promote. They are deemed beneficial to the country, and this benefit constitutes the consideration, and, in most cases, the sole consideration of the grant. In most eleemosynary institutions the object would be difficult, perhaps unattainable, without the aid of a charter of incorporation. Charitable or public spirited individuals, desirous of making permanent appropriations for charitable

or other useful purposes, find it impossible to effect their design securely, and certainly, without an incorporating act. They apply to the government, state their beneficent object, and offer to advance the money necessary for its accomplishment, provided the government will confer on the instrument which is to execute their designs the capacity to execute them. The proposition is considered and approved. The benefit to the public is considered as an ample compensation for the faculty it confers, and the corporation is created. If the advantages to the public constitute a full compensation for the faculty it gives, there can be no reason for exacting a further compensation by claiming a right to exercise over this artificial being a power which changes its nature, and touches the fund, for the security and application of which it was created. There can be no reason for implying in a charter, given for a valuable consideration, a power which is not only not expressed, but is in direct contradiction to its express stipulations.

From the fact, then, that a charter of incorporation has been granted, nothing can be inferred which changes the character of the institution, or transfers to the government any new power over it. The character of civil institutions does not grow out of their incorporation, but out of the manner in which they are formed, and the objects for which they are created. The right to change them is not founded on their being incorporated, but on their being the instruments of government, created for its purpose. The same institutions, created for the same objects, though not incorporated, would be public institutions, and, of course, be controllable by the legislature. The incorporating act neither gives nor prevents this control. Neither, in reason, can the incorporating act change the character of a private eleemosynary institution.

We are next led to the inquiry, for whose benefit the property given to Dartmouth College was secured. The counsel for the defendant have insisted that the beneficial interest is in the people of New Hampshire. The charter, after reciting the preliminary measures which had been taken, and the application for an act of incorporation, proceeds thus: "Know ye, therefore, that we, considering the premises, and being willing to encourage the laudable and charitable design of spreading Christian knowledge among the savages of our American wilderness, and, also, that the best means of education be established, in our province of New Hampshire, for the benefit of said province, do, of our special grace," etc. Do these expressions bestow on New Hampshire any exclusive right to the property of the college and exclusive interest in the labors of the professors? Or do they merely indicate a willingness that New Hampshire should enjoy those advantages which result to all from the establishment of a seminary of learning in the neighborhood? On this point we think it impossible to entertain a serious doubt. The words themselves, unexplained by the context, indicate that the "benefit intended for the province" is that which is derived from "establishing the best means of



education therein"; that is, from establishing in the province Dartmouth College, as constituted by the charter. But, if these words, considered alone, could admit of doubt, that doubt is completely removed by an inspection of the entire instrument.

The particular interest of New Hampshire never entered into the mind of the donors, never constituted a motive for their donation. The propagation of the Christian religion among the savages, and the dissemination of useful knowledge among the youth of the country, were the avowed and the sole objects of their contributions. In these New Hampshire would participate; but nothing particular or exclusive was intended for her. Even the site of the college was selected, not for the sake of New Hampshire, but because it was "most subservient to the great ends in view," and because liberal donations of land were offered by the proprietors on condition that the institution should be there established. The real advantages from the location of the college are, perhaps, not less considerable to those on the west than to those on the east side of the Connecticut river. The clause which constitutes the incorporation, and expresses the objects for which it was made, declares those objects to be the instruction of the Indians, "and also of English youth, and any others." So that the objects of the contributors and the incorporating act were the same; the promotion of Christianity and of education generally, not the interests of New Hampshire particularly.

From this review of the charter it appears that Dartmouth College is an eleemosynary institution, incorporated for the purpose of perpetuating the application of the bounty of the donors to the specified objects of that bounty; that its trustees or governors were originally named by the founder, and invested with the power of perpetuating themselves; that they are not public officers, nor is it a civil institution, participating in the administration of government; but a charity school, or a seminary of education, incorporated for the preservation of its property, and the perpetual application of that property to the objects of its creation.

Yet a question remains to be considered, of more real difficulty, on which more doubt has been entertained than on all that have been discussed. The founders of the college, at least those whose contributions were in money, have parted with the property bestowed upon it, and their representatives have no interest in that property. The donors of land are equally without interest so long as the corporation shall exist. Could they be found, they are unaffected by any alteration in its constitution, and probably regardless of its form, or even of its existence. The students are fluctuating, and no individual among our youth has a vested interest in the institution which can be asserted in a court of justice. Neither the founders of the college nor the youth for whose benefit it was founded complain of the alteration made in its charter, or think themselves injured by it. The trus-

tees alone complain, and the trustees have no beneficial interest to be protected. Can this be such a contract as the constitution intended to withdraw from the power of state legislation? Contracts, the parties to which have a vested beneficial interest, and those only, it has been said, are the objects about which the constitution is solicitous, and to which its protection is extended.

The court has bestowed on this argument the most deliberate consideration, and the result will be stated. Dr. Wheelock, acting for himself, and for those who, at his solicitation, had made contributions to his school, applied for this charter, as the instrument which should enable him, and them, to perpetuate their beneficent intention. It was granted. An artificial, immortal being was created by the crown, capable of receiving and distributing forever, according to the will of the donors, the donations which should be made to it. On this being the contributions which had been collected were immediately bestowed. These gifts were made, not, indeed, to make a profit, for the donors or their posterity, but for something in their opinion of inestimable value; for something which they deemed a full equivalent for the money with which it was purchased. The consideration for which they stipulated is the perpetual application of the fund to its object, in the mode prescribed by themselves. Their descendants may take no interest in the preservation of this consideration. But in this respect their descendants are not their representatives. They are represented by the corporation. The corporation is the assignee of their rights, stands in their place, and distributes their bounty as they would themselves have distributed it had they been immortal. So with respect to the students who are to derive learning from this source. The corporation is a trustee for them also. Their potential rights, which, taken distributively, are imperceptible, amount collectively to a most important interest. These are, in the aggregate, to be exercised, asserted, and protected by the corporation. They were as completely out of the donors at the instant of their being vested in the corporation, and as incapable of being asserted by the students, as at present.

According to the theory of the British constitution, their parliament is omnipotent. To annul corporate rights might give a shock to public opinion, which that government has chosen to avoid, but its power is not questioned. Had parliament, immediately after the emanation of this charter, and the execution of those conveyances which followed it, annulled the instrument, so that the living donors would have witnessed the disappointment of their hopes, the perfidy of the transaction would have been universally acknowledged. Yet then, as now, the donors would have had no interest in the property; then, as now, those who might be students would have had no rights to be violated; then, as now, it might be said that the trustees, in whom the rights of all were combined, possessed no private, individual, beneficial interest in the property confided to their protection. Yet the contract would at that time have been deemed sacred by all. What has since occurred

to strip it of its inviolability? Circumstances have not changed it. In reason, in justice, and in the law it is now what it was in 1769.

This is plainly a contract to which the donors, the trustees, and the crown (to whose rights and obligations New Hampshire succeeds) were the original parties. It is a contract made on a valuable consideration. It is a contract for the security and disposition of property. It is a contract on the faith of which real and personal estate has been conveyed to the corporation. It is then a contract within the letter of the constitution, and within its spirit also, unless the fact that the property is invested by the donors in trustees for the promotion of religion and education, for the benefit of persons who are perpetually changing, though the objects remain the same, shall create a particular exception, taking this case out of the prohibition contained in the constitution.

It is more than possible that the preservation of rights of this description was not particularly in the view of the framers of the constitution when the clause under consideration was introduced into that instrument. It is probable that interferences of more frequent recurrence, to which the temptation was stronger, and of which the mischief was more extensive, constituted the great motive for imposing this restriction on the state legislatures. But although a particular and a rare case may not, in itself, be of sufficient magnitude to induce a rule, yet it must be governed by the rule, when established, unless some plain and strong reason for excluding it can be given. It is not enough to say that this particular case was not in the mind of the convention when the article was framed, nor of the American people when it was adopted. It is necessary to go farther, and to say that, had this particular case been suggested, the language would have been so varied as to exclude it, or it would have been made a special exception. The case being within the words of the rule, must be within its operation likewise, unless there be something in the literal construction so obviously absurd, or mischievous, or repugnant to the general spirit of the instrument, as to justify those who expound the constitution in making it an exception.

On what safe and intelligible ground can this exception stand? There is no expression in the constitution, no sentiment delivered by its contemporaneous expounders, which would justify us in making it. In the absence of all authority of this kind, is there, in the nature and reason of the case itself, that which would sustain a construction of the constitution not warranted by its words? Are contracts of this description of a character to excite so little interest that we must exclude them from the provisions of the constitution as being unworthy of the attention of those who framed the instrument? Or does public policy so imperiously demand their remaining exposed to legislative alteration as to compel us, or rather permit us, to say that these words, which were introduced to give stability to contracts, and which in their plain import comprehend this contract, must yet be so construed as to exclude it?



Almost all eleemosynary corporations, those which are created for the promotion of religion, of charity, or of education, are of the same character. The law of this case is the law of all. In every literary or charitable institution, unless the objects of the bounty be themselves incorporated, the whole legal interest is in trustees, and can be asserted only by them. The donors or claimants of the bounty, if they can appear in court at all, can appear only to complain of the trustees. In all other situations they are identified with, and personated by, the trustees, and their rights are to be defended and maintained by them. Religion, charity and education are, in the law of England, legatees or donees, capable of receiving bequests or donations in this form. They appear in court, and claim or defend by the corporation. Are they of so little estimation in the United States that contracts for their benefit must be excluded from the protection of words which, in their natural import, include them? Or do such contracts so necessarily require new modeling by the authority of the legislature that the ordinary rules of construction must be disregarded in order to leave them exposed to legislative alteration?

All feel that these objects are not deemed unimportant in the United States. The interest which this case has excited proves that they are not. The framers of the constitution did not deem them unworthy of its care and protection. They have, though in a different mode, manifested their respect for science by reserving to the government of the Union the power "to promote the progress of science and useful arts by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries." They have so far withdrawn science and the useful arts from the action of the state governments. Why, then, should they be supposed so regardless of contracts made for the advancement of literature as to intend to exclude them from provisions made for the security of ordinary contracts between man and man? No reason for making this supposition is perceived.

If the insignificance of the object does not require that we should exclude contracts respecting it from the protection of the constitution, neither, as we conceive, is the policy of leaving them subject to legislative alteration so apparent as to require a forced construction of that instrument in order to effect it. These eleemosynary institutions do not fill the place which would otherwise be occupied by government, but that which would otherwise remain vacant. They are complete acquisitions to literature. They are donations to education, donations which any government must be disposed rather to encourage than to discountenance. It requires no very critical examination of the human mind to enable us to determine that one great inducement to these gifts is the conviction felt by the giver that the disposition he makes of them is immutable. It is probable that no man ever was, and that no man ever will be, the founder of a college, believing at the time that an act of incorporation constitutes no security for the institution; be-

believing that it is immediately to be deemed a public institution, whose funds are to be governed and applied, not by the will of the donor, but by the will of the legislature. All such gifts are made in the pleasing, perhaps delusive, hope that the charity will flow forever in the channel which the givers have marked out for it. If every man finds in his own bosom strong evidence of the universality of this sentiment, there can be but little reason to imagine that the framers of our constitution were strangers to it, and that, feeling the necessity and policy of giving permanence and security to contracts, of withdrawing them from the influence of legislative bodies, whose fluctuating policy and repeated interferences produced the most perplexing and injurious embarrassments, they still deemed it necessary to leave these contracts subject to those interferences. The motives for such an exception must be very powerful to justify the construction which makes it.

The motives suggested at the bar grow out of the original appointment of the trustees, which is supposed to have been in a spirit hostile to the genius of our government, and the presumption that, if allowed to continue themselves, they now are, and must remain forever, what they originally were. Hence is inferred the necessity of applying to this corporation, and to other similar corporations, the correcting and improving hand of the legislature.

It has been urged repeatedly, and certainly with a degree of earnestness which attracted attention, that the trustees, deriving their power from a regal source, must necessarily partake of the spirit of their origin, and that their first principles, unimproved by that resplendent light which has been shed around them, must continue to govern the college and to guide the students. Before we inquire into the influence which this argument ought to have on the constitutional question, it may not be amiss to examine the fact on which it rests. The first trustees were undoubtedly named in the charter by the crown, but at whose suggestion were they named? By whom were they selected? The charter informs us. Dr. Wheelock had represented "that, for many weighty reasons, it would be expedient that the gentlemen whom he had already nominated in his last will to be trustees in America should be of the corporation now proposed." When, afterwards, the trustees are named in the charter, can it be doubted that the persons mentioned by Dr. Wheelock in his will were appointed? Some were probably added by the crown, with the approbation of Dr. Wheelock. Among these is the doctor himself. If any others were appointed at the instance of the crown, they are the governor, three members of the council, and the speaker of the house of representatives of the colony of New Hampshire. The stations filled by these persons ought to rescue them from any other imputation than too great a dependence on the crown. If, in the revolution that followed, they acted under the influence of this sentiment, they must have ceased to be trustees; if they took part with their countrymen, the imputation which suspicion might excite would no longer attach to them. The original trustees, then, or

most of them, were named by Dr. Wheelock, and those who were added to his nomination, most probably with his approbation, were among the most eminent and respectable individuals in New Hampshire.

The only evidence which we possess of the character of Dr. Wheelock is furnished by this charter. The judicious means employed for the accomplishment of his object, and the success which attended his endeavors, would lead to the opinion that he united a sound understanding to that humanity and benevolence which suggested his undertaking. It surely can not be assumed that his trustees were selected without judgment. With as little probability can it be assumed that, while the light of science and of liberal principles pervades the whole community, these originally benighted trustees remain in utter darkness, incapable of participating in the general improvement; that, while the human race is rapidly advancing, they are stationary. Reasoning *a priori*, we should believe that learned and intelligent men, selected by its patrons for the government of a literary institution, would select learned and intelligent men for their successors; men as well fitted for the government of a college as those who might be chosen by other means. Should this reasoning ever prove erroneous in a particular case, public opinion, as has been stated, at the bar, would correct the institution. The mere possibility of the contrary would not justify a construction of the constitution which should exclude these contracts from the protection of a provision whose terms comprehend them.

The opinion of the court, after mature deliberation, is that this is a contract, the obligation of which cannot be impaired without violating the constitution of the United States. This opinion appears to us to be equally supported by reason and by the former decisions of this court.

2. We next proceed to the inquiry whether its obligation has been impaired by those acts of the legislature of New Hampshire to which the special verdict refers.

From the review of this charter which has been taken it appears that the whole power of governing the college, of appointing and removing tutors, of fixing their salaries, of directing the course of study to be pursued by the students, and of filling up vacancies created in their own body, was vested in the trustees. On the part of the crown it was expressly stipulated that this corporation, thus constituted, should continue forever, and that the number of trustees should forever consist of twelve, and no more. By this contract the crown was bound, and could have made no violent alteration in its essential terms without impairing its obligation.

By the revolution the duties, as well as the powers, of government devolved on the people of New Hampshire. It is admitted that among the latter was comprehended the transcendent power of parliament, as well as that of the executive department. It is too clear to require the support of argument that all contracts and rights respecting property



remained unchanged by the revolution. The obligations, then, which were created by the charter to Dartmouth College were the same in the new that they had been in the old government. The power of the government was also the same. A repeal of this charter at any time prior to the adoption of the present constitution of the United States would have been an extraordinary and unprecedented act of power, but one which could have been contested only by the restrictions upon the legislature to be found in the constitution of the state. But the constitution of the United States has imposed this additional limitation, that the legislature of a state shall pass no act "impairing the obligation of contracts."

It has been already stated that the act "to amend the charter, and enlarge and improve the corporation of Dartmouth College," increases the number of trustees to twenty-one, gives the appointment of the additional members to the executive of the state, and creates a board of overseers, to consist of twenty-five persons, of whom twenty-one are also appointed by the executive of New Hampshire, who have power to inspect and control the most important acts of the trustees.

On the effect of this law two opinions cannot be entertained. Between acting directly and acting through the agency of trustees and overseers no essential difference is perceived. The whole power of governing the college is transferred from trustees appointed according to the will of the founder, expressed in the charter, to the executive of New Hampshire. The management and application of the funds of this eleemosynary institution, which are placed by the donors in the hands of trustees named in the charter, and empowered to perpetuate themselves, are placed by this act under the control of the government of the state. The will of the state is substituted for the will of the donors in every essential operation of the college. This is not an immaterial change. The founders of the college contracted not merely for the perpetual application of the funds which they gave to the objects for which those funds were given; they contracted also to secure that application by the constitution of the corporation. They contracted for a system which should, as far as human foresight can provide, retain forever the government of the literary institution they had formed in the hands of persons approved by themselves. This system is totally changed. The charter of 1769 exists no longer. It is reorganized, and reorganized in such a manner as to convert a literary institution, moulded according to the will of its founders, and placed under the control of private literary men, into a machine entirely subservient to the will of government. This may be for the advantage of this college in particular, and may be for the advantage of literature in general, but it is not according to the will of the donors, and is subversive of that contract on the faith of which their property was given.

In the view which has been taken of this interesting case, the court has confined itself to the rights possessed by the trustees, as the assignees and representatives of the donors and founders, for the benefit

of religion and literature. Yet it is not clear that the trustees ought to be considered as destitute of such beneficial interest in themselves as the law may respect. In addition to their being the legal owners of the property, and to their having a freehold right in the powers confided to them, the charter itself countenances the idea that trustees may also be tutors with salaries. The first president was one of the original trustees, and the charter provides that in case of vacancy in that office "the senior professor or tutor, being one of the trustees, shall exercise the office of president until the trustees shall make choice of and appoint a president." According to the tenor of the charter, then, the trustees might, without impropriety, appoint a president and other professors from their own body. This is a power not entirely unconnected with an interest. Even if the proposition of the counsel for the defendant were sustained; if it were admitted that those contracts only are protected by the constitution, a beneficial interest in which is vested in the party who appears in court to assert that interest; yet it is by no means clear that the trustees of Dartmouth College have no beneficial interest in themselves.

But the court has deemed it unnecessary to investigate this particular point, being of opinion, on general principles, that in these private eleemosynary institutions the body corporate, as possessing the whole legal and equitable interest, and completely representing the donors, for the purpose of executing the trust, has rights which are protected by the constitution.

It results from this opinion that the acts of the legislature of New Hampshire, which are stated in the special verdict found in this cause, are repugnant to the constitution of the United States, and that the judgment on this special verdict ought to have been for the plaintiffs. The judgment of the state court must therefore be reversed.

## II. Police Power of the State \*

### ATLANTIC COAST LINE R. CO. v. GOLDSBORO.

(Supreme Court of the United States, 1913. 232 U. S. 548, 34 Sup. Ct. 364, 58 L. Ed. 721.)

Mr. JUSTICE PITNEY delivered the opinion of the court:

The Atlantic Coast Line Railroad Company, plaintiff in error, has succeeded to the ownership of the property, franchises, and rights of the Wilmington & Raleigh Railroad Company, which was chartered by the general assembly of North Carolina in the year 1833, and whose

\* For discussion of principles, see Clark on Corp. (3d Ed.) § 75.

name was afterwards changed to Wilmington & Weldon Railroad Company. Under its charter powers the original company constructed its railroad from Wilmington to and into Wayne county, North Carolina, passing through the place which later, and in the year 1847, became incorporated as the town of Goldsboro, now the city of Goldsboro, defendant in error.

For the purposes of its railroad, the Wilmington & Raleigh Company acquired a strip of land 130 feet wide, extending through Goldsboro from north to south, and constructed its road upon it before the incorporation of the town. The land was acquired in part under deeds conveying title in fee simple, in part by condemnation proceedings which conferred upon the company, as is claimed, the equivalent of a fee simple. Afterwards, two other companies, designated respectively as the North Carolina Railroad Company and the Atlantic & North Carolina Railroad Company, with the consent and permission of the Wilmington & Raleigh, or Wilmington & Weldon, and under agreements with that company, constructed their railroad tracks upon the same "right of way."

The town naturally grew along the railroad, and the right of way, so far as not occupied by the tracks, was and still is used for the ordinary purposes of a street, without objection by plaintiff in error or its predecessors in title. In laying out the town, this right of way was designated as a street 130 feet wide; the portion lying east of the tracks being designated as East Center street, the portion on the west of the tracks as West Center street. Cross streets were laid out, designated successively (commencing at the north) as Holly, Beech, Vine, Oak, Ash, Mulberry, Walnut, Chestnut, Spruce, Pine, and Elm streets. East and West Center streets have become the principal business streets of the town and the portion between Ash and Spruce—four blocks—is the heart of the city.

During the years since the incorporation of Goldsboro numerous industries have been and are now located on East and West Center streets, and the track of plaintiff in error, in addition to its use as a part of the main line, has been and is used by the company in shifting cars into and out of these industries, and also for reaching the freight terminals of the other two railroads, which are in the northerly part of the town; the terminal of plaintiff in error being in the southerly part. A belt line has been built around the city, over which through passenger trains and some freight trains are moved, but the use of the old main line for connecting with the other terminals, for shifting cars into industries, and loading tracks along the right of way, and for the passage of certain of its trains, is claimed by plaintiff in error to be still essential to its business.

The municipal corporation has for many years worked and maintained its streets and cross streets, including so much of the surface of East and West Center streets as lies outside of the space actually



occupied by the railroad tracks. More recently it has instituted a system of street grades and of drainage extending throughout the city, and has paved a considerable part of East and West Center streets in conformity to the grade so established. From Chestnut street north the railroad tracks are (or, at least, prior to the municipal action complained of they were) from 6 to 18 inches above the established street grade; the tracks south of Chestnut street being in a cut from 1 to 8 feet deep.

In November, 1909, the board of aldermen passed an ordinance or ordinances containing the following provisions: Section 1 rendered it unlawful for any railroad company to run any freight or passenger train on East or West Center streets at a rate of speed exceeding 4 miles per hour, and required the companies to have flagmen proceed 50 feet in front of every train to warn persons of its approach. Section 2 provided that the shifting limits on East and West Center streets should be from Spruce street to the city limits on the south, and from Ash street to the city limits on the north; thus excluding the four blocks between Spruce and Ash streets. Section 3 declared it to be unlawful for any railroad company to do any shifting within those four blocks at any other time than between the hours of 6:30 and 8:30 a. m., and between 4:30 and 6:30 p. m. Section 4 rendered it unlawful for any railroad company to place any car and allow it to stand for a longer period than five minutes at any point on East and West Center streets within the same four blocks. Section 5 required all railroad companies owning tracks on East and West Center streets between Walnut and Vine (four blocks) to lower the tracks so as to make them conform to the grade line of the streets, and to fill in the tracks between the rails; the required lowering being specified as 6 inches from Walnut to Mulberry, 10 inches between Mulberry and Ash, and 18 inches between Ash and Vine streets. Substantial penalties were prescribed for violations of these prohibitions.

Plaintiff in error began this action against the city of Goldsboro in the superior court of Wayne county, seeking to restrain the enforcement of the ordinances. A temporary restraining order was granted. At the hearing, the objection to the enforcement of section 1 was abandoned by plaintiff; as to the other sections the court vacated the restraining order. Upon appeal, the supreme court of North Carolina affirmed the judgment. 155 N. C. 356, 71 S. E. 514. The present writ of error under § 709, Rev. Stat. U. S. Comp. Stat. 1901, p. 575 (Judicial Code, § 237 [36 Stat. at L. 1156, chap. 231, U. S. Comp. Stat. 1913, § 1214]), is based upon the insistence, made in the state courts and there overruled, that the ordinances impair the obligation of the contract contained in the charter of the company, in contravention of section 10 of article 1, of the Federal Constitution, and deprive the company of its property without due process of law, in contravention of the Fourteenth Amendment.

The supreme court of the state construed the section forbidding shifting as having reference to the "cutting out and putting in" of cars in the making up of a train before it is despatched upon its journey, and not as referring to the "transfer" of a train of cars, already made up by plaintiff in error, to another railroad company for transportation. In view of the fact that plaintiff in error has shifting yards farther from the center of the city, where its trains can be made up and at least the chief part of the necessary shifting done, the court held it to be a reasonable exercise of the police power to forbid car shifting, except within the limited hours specified, on the four blocks of the plaintiff's track that lie in the heart of the city; declaring this regulation to be necessary for the convenience and safety of the public at the crossings.

With reference to the section requiring the lowering of the tracks between Walnut and Vine streets so as to make them conform to the grade lines of the streets, the court held that the company took its charter subject to the right of the state to lay out new roads and streets, and to require the company to make such alterations as would prevent the public passage over its tracks from being impeded; and that there was no contract exempting the railroad from changing its grade at crossings when required.

In this court, plaintiff in error abandons its attack upon the right of the city to require a change of grade at the street crossings. The controversy, therefore, is now limited to (a) the restrictions imposed by sections 2 and 3 upon shifting operations on East and West Center streets between Spruce and Ash streets; (b) the prohibition of section 4 against the standing of cars for a longer period than five minutes within the same four blocks; and (c) the requirement under section 5 that the tracks from Walnut to Vine streets shall conform to the grade of East and West Center streets, and shall be filled in between the rails, elsewhere than at the crossing streets. Upon the argument, it was stated by counsel representing the city that plaintiff in error had complied with the decision of the state court as to section 5, at least, to the extent of lowering its tracks. But there was no clear admission of the fact in behalf of plaintiff in error, and we shall therefore disregard the supposed compliance.

It is, among other things, contended by plaintiff in error that the ordinances are not within the powers conferred by the legislature of North Carolina upon the municipal corporation. This is a question of state law, which, for present purposes, is conclusively settled by the decision of the supreme court of North Carolina in this case. *Merchants' & M. Nat. Bank v. Pennsylvania*, 167 U. S. 461, 462, 42 L. Ed. 236, 237, 17 Sup. Ct. 829, and cases cited; *Lombard v. West Chicago Park Comrs.*, 181 U. S. 33, 43, 45 L. Ed. 731, 737, 21 Sup. Ct. 507.

A municipal by-law or ordinance, enacted by virtue of power for that purpose delegated by the legislature of the state, is a state law

within the meaning of the Federal Constitution. *New Orleans Waterworks Co. v. Louisiana Sugar Ref. Co.*, 125 U. S. 18, 31, 31 L. Ed. 607, 612, 8 Sup. Ct. 741; *Hamilton Gaslight & Coke Co. v. Hamilton*, 146 U. S. 258, 266, 36 L. Ed. 963, 967, 13 Sup. Ct. 90; *St. Paul Gaslight Co. v. St. Paul*, 181 U. S. 142, 148, 45 L. Ed. 788, 791, 21 Sup. Ct. 575; *Northern P. R. Co. v. Minnesota*, 208 U. S. 583, 590, 52 L. Ed. 630, 633, 28 Sup. Ct. 341; *Grand Trunk Western R. Co. v. Railroad Commission*, 221 U. S. 400, 403, 55 L. Ed. 786, 787, 31 Sup. Ct. 537; *Ross v. Oregon*, 227 U. S. 150, 162, 57 L. Ed. 458, 463, 33 Sup. Ct. 220, Ann. Cas. 1914C, 224.

And any enactment, from whatever source originating, to which a state gives the force of law, is a statute of the state, within the meaning of the pertinent clause of section 709, Rev. Stat., Judicial Code, § 237, which confers jurisdiction on this court. *Williams v. Bruffy*, 96 U. S. 176, 183, 24 L. Ed. 716, 717.

We must therefore treat the ordinances as legislation enacted by virtue of the lawmaking power of the state. They are manifestly an exertion of the police power, and the question is whether, viewed in that light, they run counter to the "contract" or "due process" clauses.

That a railroad charter may embody a contract, within the meaning of the Constitution, hardly needs to be stated. *Dartmouth College v. Woodward*, 4 Wheat. 518, 4 L. Ed. 629. In the present case the supreme court of North Carolina held that by the Constitution of the state, the charter was subject to alteration or repeal at the legislative will. If the right of repeal was indeed thus reserved, the result is obvious. *Greenwood v. Union Freight R. Co.*, 105 U. S. 13, 21, 26 L. Ed. 961, 965; *Knoxville Water Co. v. Knoxville*, 189 U. S. 434, 437, 47 L. Ed. 887, 891, 23 Sup. Ct. 531. But when this court has under review the judgment of a state court by virtue of section 709, Rev. Stat., U. S. Comp. Stat. 1901, p. 575, and the validity of a state law is challenged on the ground that it impairs the obligation of a contract, this court must determine for itself the existence or nonexistence of the asserted contract, and whether its obligation has been impaired. *Douglas v. Kentucky*, 168 U. S. 488, 502, 42 L. Ed. 553, 557, 18 Sup. Ct. 199; *Stearns v. Minnesota*, 179 U. S. 223, 233, 45 L. Ed. 162, 170, 21 Sup. Ct. 73. We are not referred to and are unable to find, in the state Constitution as it existed when the charter now in question was granted, any reservation of the right of repeal, and will assume for present purposes that the contract was not thus qualified, and deal only with the question whether it has been impaired.

Plaintiff in error lays more particular stress upon the insistence that its property rights in the street will be infringed by the enforcement of the ordinances. Because its predecessors acquired the strip of land in fee simple, and because the municipal corporation has never condemned it or made compensation for its use as a street, the contention is that the title of the railroad company remains until now, absolute and



unqualified. Reference is made to Rev. Code (N. C.) chap. 65, § 23. This section, it seems, became law in North Carolina in the year 1854, and has remained upon the statute books continuously until the present time, appearing now as section 388 of the Revisal of 1908; see also Code 1883, § 150. It provides that "no railroad, plank road, turnpike, or canal company shall be barred of, or presumed to have conveyed, any real estate, right of way, easement, leasehold, or other interest in the soil which may have been condemned, or otherwise obtained for its use, as a right of way, depot, station house or place of landing, by any statute of limitation, or by occupation of the same by any person whatever." Two cases, *Seaboard Air Line R. Co. v. Olive*, 142 N. C. 257, 271, 55 S. E. 263, and *Muse v. Seaboard Air Line R. Co.*, 149 N. C. 443, 446, 63 S. E. 102, 19 L. R. A. (N. S.) 453, are cited as supporting the proposition that under this statute a permissive use of any portion of the railroad right of way by others, or even by the public as a street, cannot impair the title of the company unless at least there be adverse user or possession for a sufficient period to satisfy the statutes on that subject; and it is insisted there has been none. But in both cases the question was as to the effect of the permissive user or possession upon merely private rights, and in the *Muse* Case it was expressly conceded (149 N. C. 446, 63 S. E. 102, 19 L. R. A. [N. S.] 453) that the rights of the railroad company in that portion of its right of way that had been used as a street were subject to the police power of the town. In the present case, likewise, the state court (155 N. C. 363, 71 S. E. 514) treated the question of the ownership of the soil as not involved in the decision.

And we are not at present particularly concerned with either contract or property rights, except as they may serve to show the conditions under which the ordinances were adopted, and may bear upon the question of the reasonableness of those regulations. These have to do with the use and control of the property, rather than with its ownership; with the mode in which the franchise shall be enjoyed, rather than with its scope. Conceding, for argument's sake only, the utmost that may be claimed as to the charter and property rights of plaintiff in error, we still have yielded nothing that may defeat the exercise of the police power by the state, or by its authorized agency. Adopting the extreme assumption that the railroad company has still a complete and unqualified ownership of every portion of the strip of land that was originally acquired in fee simple, and as proprietor might lawfully exercise its dominion by excluding the public from it; yet it does not do this, but permits, and long has permitted, the public to use material portions of the strip for ordinary street purposes; it apparently excludes the public from no portion except as the existence of the tracks and the passage of trains may have such a tendency or effect. And thus the company, at least for the time, devotes its prop-

erty in part to public uses that are more or less inconsistent with the railroad uses, and under conditions such as to render the railroad operations necessarily a source of danger to the public while enjoying the permitted use. Under such circumstances the state, in the exercise of the police power, may legitimately extend the application of the principle that underlies the maxim, *Sic utere tuo ut alienum non lædas*, so far as may be requisite for the protection of the public.

For it is settled that neither the "contract" clause nor the "due process" clause has the effect of overriding the power of the state to establish all regulations that are reasonably necessary to secure the health, safety, good order, comfort, or general welfare of the community; that this power can neither be abdicated nor bargained away, and is inalienable even by express grant; and that all contract and property rights are held subject to its fair exercise. *Slaughter House Cases*, 16 Wall, 36, 62, 21 L. Ed. 394, 404; *Munn v. Illinois*, 94 U. S. 113, 125, 24 L. Ed. 77, 84; *Boston Beer Co. v. Massachusetts*, 97 U. S. 25, 33, 24 L. Ed. 989, 992; *Mugler v. Kansas*, 123 U. S. 623, 665, 31 L. Ed. 205, 211, 8 Sup. Ct. 273; *Crowley v. Christensen*, 137 U. S. 86, 89, 34 L. Ed. 620, 621, 11 Sup. Ct. 13; *New York & N. E. R. Co. v. Bristol*, 151 U. S. 556, 567, 38 L. Ed. 269, 272, 14 Sup. Ct. 437; *Texas & N. O. R. Co. v. Miller*, 221 U. S. 408, 414, 415, 55 L. Ed. 789, 795, 796, 31 Sup. Ct. 534. And the enforcement of uncompensated obedience to a regulation established under this power for the public health or safety is not an unconstitutional taking of property without compensation or without due process of law. *Chicago, B. & Q. R. Co. v. Chicago*, 166 U. S. 226, 255, 41 L. Ed. 979, 991, 17 Sup. Ct. 581; *New Orleans Gas Light Co. v. Drainage Commission*, 197 U. S. 453, 462, 49 L. Ed. 831, 835, 25 Sup. Ct. 471; *Chicago, B. & Q. R. Co. v. Illinois*, 200 U. S. 561, 591, 592, 50 L. Ed. 596, 608, 609, 26 Sup. Ct. 341, 4 Ann. Cas. 1175.

Of course, if it appear that the regulation under criticism is not in any way designed to promote the health, comfort, safety, or welfare of the community, or that the means employed have no real and substantial relation to the avowed or ostensible purpose, or that there is wanton or arbitrary interference with private rights, the question arises whether the law-making body has exceeded the legitimate bounds of the police power.

The ordinances now in question must be considered in view not only of the charter and property rights of plaintiff in error, but of the actual situation that has developed and now exists in Goldsboro, with the consent and long acquiescence of plaintiff in error and its predecessors in interest. A town of considerable size and importance has grown up along the line of the railroad. The strip of land 130 feet in width, so far as it is not occupied by the railroad tracks, for many years has been and still is used for the ordinary purposes of a street. The supreme court of North Carolina found, upon adequate evidence, that it is the main business street of the town, frequently crowded with

pedestrians and vehicles; and that the operation of trains along it, notwithstanding the utmost care of the railroad company, tends to obstruct the crossings and is fraught with danger to life and property. There are, within the blocks covered by the ordinances, two main lines of railway besides that of plaintiff in error. These, of course, complicate the situation by narrowing the spaces available for ordinary travel north and south on East and West Center streets, and must also enhance the dangers at the crossings.

It is very properly conceded that the company may be required to limit the speed of its trains, and to have flagmen precede them to warn persons of their approach; and that the company may be required to change its grade at the street crossings. In *New York & N. E. R. Co. v. Bristol*, 151 U. S. 556, 567, 38 L. Ed. 269, 272, 14 Sup. Ct. 437, this court sustained a Connecticut statute directed to the extinction of grade crossings as a menace to public safety, and compelling this to be done at the expense of the companies, although the grade crossings had been long before established under legislative authority. In *Chicago, B. & Q. R. Co. v. Chicago*, 166 U. S. 226, 251, 41 L. Ed. 979, 989, 17 Sup. Ct. 581, it was held that when the city opened a new street across the railroad it was not bound to take and pay for the fee in the land, but only to make compensation to the extent that the value of the company's right to use the land for railroad purposes was diminished by opening the street across it; and that the company was not entitled to have its compensation increased because of the fact that in order to safeguard the crossing it would thereafter be obliged to construct gates, and a tower for operating them, plank the crossing, fill in between the rails, and incur certain annual expenses for depreciation, maintenance, employment of gatemen, etc. To the same effect are *Wabash R. Co. v. Defiance*, 167 U. S. 88, 97, 42 L. Ed. 87, 91, 17 Sup. Ct. 748; *Chicago, B. & Q. R. Co. v. Nebraska*, 170 U. S. 57, 75, 42 L. Ed. 948, 954, 18 Sup. Ct. 513; *Northern P. R. Co. v. Minnesota*, 208 U. S. 583, 597, 52 L. Ed. 630, 636, 28 Sup. Ct. 341; *Cincinnati, I. & W. R. Co. v. Connersville*, 218 U. S. 336, 343, 54 L. Ed. 1060, 1064, 31 Sup. Ct. 93, 20 Ann. Cas. 1206; *Chicago, M. & St. P. R. Co. v. Minneapolis* (decided this day) 232 U. S. 430, 58 L. Ed. 671, 34 Sup. Ct. 400. And see *Grand Trunk Western R. Co. v. South Bend*, 227 U. S. 544, 554, 33 Sup. Ct. 303, 57 L. Ed. 633, 639, 44 L. R. A. (N. S.) 405.

But manifestly the tracks cannot be brought to the street grade at the crossings without being lowered between the crossings as well. And if this is to be done, it follows that not merely the tracks, but the surface adjacent to the tracks, must be made to conform to the established grade of East and West Center streets between the crossing streets; or else the street will be rendered materially less convenient for purposes of north-and-south travel, and the drainage will be materially interfered with; or at least the municipal authorities might reasonably so determine. The establishment of a proper system of drainage for the city in the interest of the public health and general



welfare is an object that legitimately invokes the exercise of the police power. *New Orleans Gas Light Co. v. Drainage Commission*, 197 U. S. 453, 460, 49 L. Ed. 831, 834, 25 Sup. Ct. 471.

As to filling in between the rails, elsewhere than at the crossing streets, we have to do not merely with the necessities of drainage, but with the safety of persons crossing the railroad tracks midway of the respective street blocks. The power of the state to prescribe precautions with respect to the running of railroad trains so as to guard against injuries to the persons or property of others is not confined to the establishment of such precautions at highway crossings. State enactments requiring railroad corporations to maintain fences and cattle guards alongside the railroad have been repeatedly sustained. *Missouri P. R. Co. v. Humes*, 115 U. S. 512, 522, 29 L. Ed. 463, 466, 6 Sup. Ct. 110; *Minneapolis & St. L. R. Co. v. Beckwith*, 129 U. S. 26, 34, 32 L. Ed. 585, 588, 9 Sup. Ct. 207; *Minneapolis & St. L. R. Co. v. Emons*, 149 U. S. 364, 366, 37 L. Ed. 769, 771, 13 Sup. Ct. 870. For the purposes of the argument it may be conceded that no person has the right, as against the railroad company, to pass over its tracks except at one of the street intersections; although this may not be entirely clear. But unless excluding fences be established adjacent to the railroad tracks (and this is not proposed nor even suggested as feasible), it is inevitable that many people, with or without right (children of tender years, among others), will cross at places other than the street intersections; and a police regulation intended to prevent injuries to persons thus crossing cannot be judicially denounced as arbitrary. Other grounds for sustaining section 5 might be mentioned; but we need not further particularize.

There remain only the limitation of car shifting and the prohibition of the standing of cars upon East and West Center streets in the four blocks that lie between Spruce and Ash streets, in the heart of the city. As already pointed out, the state court construed "shifting" as applying only to the "cutting out and putting in" of cars in the making up of trains. This operation is not to be performed within the four blocks specified except during two hours in the morning and two hours in the afternoon of each day. The time limits were evidently adopted with regard to the necessities of the industries that are located along the railroad, and at the same time with a view to the necessities of general travel upon the streets. It was complained that the time allowed for shifting is inadequate; but there is nothing in the proof on this subject to overthrow the finding of the court that the ordinance is a reasonable exercise of the police power.

The prohibition against the standing of cars for a longer period than five minutes within the same four blocks is intended to prevent the loading and unloading of cars in the street, with the attendant use of wagons and drays for the purpose. In view of the obstruction to street travel that is naturally incident to such operations, the prohibition cannot be deemed wholly unreasonable. In effect it prevents ordinary

travel upon the street from being thus obstructed, and requires that the loading and unloading of cars shall be done at the regular freight terminals.

The regulations in question are thus found to be fairly designed to promote the public health, safety, and welfare; the measures adopted appear to be reasonably suited to the purposes they are intended to accomplish; and we are unable to say that there is any unnecessary interference with the operations of the railroad, or with the property rights of plaintiff in error. Therefore, no violation of the "contract" or "due process" clauses is shown.

Judgment affirmed.

### III. Reservation of Power to Repeal or Amend Charter \*

#### POLK v. MUTUAL RESERVE FUND.

(Supreme Court of the United States, 1907. 207 U. S. 310, 28 Sup. Ct. 65, 52 L. Ed. 222.)

On a certificate from the United States Circuit Court of Appeals for the Second Circuit presenting questions as to whether contract obligations were impaired or due process of law denied by the reorganization of an association insuring lives upon the co-operative plan as a mutual level premium company, under a new name, and without the consent of the members. Answered in the negative.

The circuit court of appeals desires instruction upon the following:

#### Questions.

"1. Does the amended bill of complaint disclose that any contract obligations between complainants and the defendant Mutual Reserve Fund Life Association were impaired by the incorporation of the Mutual Reserve Life Insurance Company in 1902, pursuant to the provisions of chapter 722, Laws 1901, of the state of New York, and the transfer to said company of the assets, properties, and membership of the Mutual Reserve Fund Life Association?

"2. Does the amended bill of complaint disclose and show that chapter 722, Laws of 1901, of the state of New York, was in violation of article 1, § 10, of the Constitution of the United States, as impairing the obligations of a contract between the defendant Mutual Reserve Fund Life Association and complainants, in so far as it authorized the reincorporation of said association as the Mutual Reserve Life Insurance Company?

"3. Does the amended bill of complaint disclose that chapter 722, Laws of 1901, of the state of New York, is in violation of the provisions of article 14 of the Amendments to the Constitution of the United

\* For discussion of principles, see Clark on Corp. (3d Ed.) § 77.

States, in this,—that the reincorporation of the Mutual Reserve Fund Life Association as the Mutual Reserve Life Insurance Company, and the changes in the charter powers and franchises of the corporation, have the effect of depriving complainants of their property without due process of law, and of their vested contract rights and privileges, and of their property rights under their contracts and agreements with respondent association?

"4. Does the amended bill of complaint disclose that chapter 722, Laws of 1901, of the state of New York, was in violation of those provisions of article 14 of the Amendments to the Constitution of the United States, which provides that no state shall make or enforce any law which shall abridge the privileges or immunities of the citizens of the United States, nor shall any state deprive any person of life, liberty, or property without due process of law, nor deny to any person within its jurisdiction the equal protection of the laws?"

Mr. JUSTICE MOODY delivered the opinion of the court: <sup>5</sup>

The Mutual Reserve Fund Life Association of New York (hereinafter called the "association") was originally incorporated under chapter 267 of the Laws of New York of 1875. The certificate of incorporation stated the purposes of the association to be to provide "benefits for families and others dependent \* \* \* by means of voluntary contributions \* \* \* and to provide a fund for the common and exclusive benefit of all members." In 1883 the association reincorporated under chapter 175, Laws of 1883, and while this charter was in existence the complainants became members and policy holders. That law provided for the incorporation and regulation of co-operative and assessment life and casualty insurance associations, and the charter of the association stated the business to be conducted as "the transaction of life insurance upon the co-operative or assessment plan." The law, as will presently be shown, was subject to alteration or repeal. In 1892 an act known as the insurance law (chapter 38 of the General Laws) was passed, repealing previous laws upon the subject of insurance, and expressed to be "applicable to all corporations authorized by law to make insurances." Section 52 of this act, as amended by chapter 722 of the Laws of 1901, is as follows:

"Sec. 52. Reorganizations of Existing Corporations and Amendment of Certificates.—Any domestic corporation existing or doing business at the time this chapter takes effect may, by a vote of a majority of its directors or trustees, accept provisions of this chapter and amend its charter to conform with the same, upon obtaining the consent of the superintendent of insurance thereto in writing; and thereafter it shall be deemed to have been incorporated under this chapter, and every such corporation, in reincorporating under this provision, may, for that purpose, so adopt, in whole or in part, a new charter, in conformity herewith, and include therein any or all provisions of its

<sup>5</sup> The statement of facts is abridged.



existing charter, and any or all changes from its existing charter, to cover and enjoy any or all the privileges and provisions of existing laws which might be so included and enjoyed if it were originally incorporated thereunder; and it shall, upon such adoption of and after obtaining the consent, as in this section before provided, to such charter, and filing the same and the record of adoption and consent in the office of the superintendent of insurance, perpetually enjoy the same as and be such corporation, and which is declared to be a continuation of such corporation which existed prior to such reincorporation; and the offices therein, which shall be continued, shall be filled by the respective incumbents for the periods for which they were elected, and all others shall be filled in the same manner by such amended charter provided. Every domestic insurance corporation may amend its charter or certificate of incorporation by inserting therein any statement or matter which might have been originally inserted therein; and the same proceedings shall be taken upon the presentation of such amended charter or certificate to the superintendent of insurance, as are required by this chapter to be taken with respect to an original charter or certificate; and if approved by the superintendent of insurance and his certificate of authority to do business thereunder is granted, the corporation shall thereafter be deemed to possess the same powers and be subject to the same liabilities as if such amended charter or certificate had been its original charter or certificate of incorporation, but without prejudice to any pending action or proceeding or any rights previously accrued. This section shall apply to insurance corporations organized under or subject to article 6 of the insurance law as well as to insurance corporations organized under special charters or articles 2 and 10 of the insurance law; all contracts, policies, and certificates issued by such corporations prior to accepting the provisions of this chapter shall be valued as one-year term insurance at the ages attained, excepting when such contracts, policies, or certificates shall provide for a limited number of specified premiums or for specified surrender values, in which case they shall be valued as provided in article 2, § 84, of the insurance law."

Following strictly the provisions of this section, the association accepted the provisions of the insurance law, amended its charter, and became entitled to all the privileges of the law as if it had been originally incorporated thereunder. In the amendments to the charter the name of the association was changed to "Mutual Reserve Life Insurance Company" (hereinafter called the "company"), and the business of the company was stated to be "insurance upon the lives or the health of persons, and all and every insurance appertaining thereto, the making of endowments, and the granting, purchasing, and dispensing of annuities." The effect of this was to broaden the business from that of merely co-operative and assessment life insurance to life insurance of every kind. It is conceded that what was done was within the author-

ity conferred by the statute, and the subject for our consideration is whether any of the rights secured to the complainants by the Constitution of the United States have been impaired.

The first question certified is whether the incorporation of the company and the transfer to it of the assets, property, and membership of the association impaired any contract obligations between the association and the complainants. This question possibly implies that by the reincorporation an entirely new corporation was created, to which the property of the old corporation was transferred. But the question must be interpreted with the aid of the statement of facts which accompanies it. An examination of the facts and of the statute shows that there was simply a reorganization of an existing corporation, and not the creation of a new one. The title of the section is, "Reorganizations of existing corporations and amendment of certificates." It authorizes an existing corporation by vote of its directors to accept the provisions of the chapter and amend its charter. It provides expressly that the corporation, with its added powers and revised charter, shall be a "continuation of such corporation which existed prior to such reincorporation." This, perhaps, makes superfluous the saving of "pending action or proceeding or any rights previously accrued" which the section cautiously insures. The declaration filed by the directors, and certified by the attorney general to be in conformity with law, recites that the association "has duly accepted the provisions" of the insurance law, and "duly adopted the following amended charter." The corporation was not changed to a stock, but continued as a mutual, company. The change of name cannot control the significance of these facts. We answer this and the other questions upon the assumption, therefore, that the old corporation was still in existence, under a new name, and with added powers, but with unchanged membership, and bound to perform all its existing obligations. Upon this view it is impossible to say that any of the contract obligations of the association to the complainants have been impaired by the reorganization. This was the view apparently accepted by the company, who, in its notice to its members, said: "This reincorporation, while insuring the stability of the company, makes no change in your policy." It is contended, however, that the last clause of the section, which is applicable to associations for insurance under the co-operative or assessment plan, affects the contracts of the old members by converting them into one-year-term insurances at the ages attained. But, as we understand this clause, it has no effect upon the contracts of insurance, but is designed for a totally different purpose. It simply prescribes a standard by which the liabilities on the assessment contracts must be appraised. The superintendent of insurance is charged with the duty of deciding whether the assets of insurance companies bear such a relation to their liabilities that it is safe to allow them to continue in business. A very large part of the liabilities of any insurance company is upon outstand-

ing contracts of insurance, not due and therefore not capable of exact measurement. Such liabilities can only be estimated or "valued." Section 84 of the insurance law provides for the method of estimating or valuing the liability on ordinary life policies, but that method seems inapplicable to assessment policies. In any event, the legislature determined that, when an assessment company was allowed to engage in other kinds of life insurance, its outstanding policies should be appraised as liabilities as if they were "one-year-term insurance at the ages attained." This does not make them such in fact, or authorize the company, in its dealings with the policy holder, to treat them as such. The statutory appraisal of the policies for bookkeeping purposes no more affects the rights of the members under their contracts than the account of stock of a merchant would affect the rights of his creditors. The first question must be answered in the negative.

The second question certified is whether the law of 1901, so far as it authorized the reincorporation of the association, was in violation of the clause of the Constitution forbidding a state from passing a law impairing the obligation of contracts. A similar question was before the court in *Wright v. Minnesota Mut. L. Ins. Co.*, 193 U. S. 657, 48 L. Ed. 832, 24 Sup. Ct. 549, where it was held that a law of Minnesota, authorizing an assessment insurance company to change its business to that of insurance upon a regular premium basis, was not in violation of this provision of the Constitution. The reasoning of the court in that case need not be repeated. It is conclusive upon this question, unless the case at bar can be distinguished from it. The complainants seek to distinguish the case in several respects, which must be noticed. First, it is said that in the *Wright Case* the power of amendment of the articles of association was reserved in the articles of association, while no such reservation exists here. But the Constitution of New York, in force since 1846 contains this provision: "Corporations may be formed under general laws; but shall not be created by special act, except for municipal purposes, and in cases where, in the judgment of the legislature, the objects of the corporation cannot be attained under general laws. All general laws and special acts passed pursuant to this section may be altered from time to time or repealed." Article 8, § 1. A constitutional provision of the state of Michigan in substantially the same words was held to authorize important changes in the articles of association of an insurance company incorporated under a general law. *Looker v. Maynard*, 179 U. S. 46, 45 L. Ed. 79, 21 Sup. Ct. 21. There it was said (179 U. S. 52, 21 Sup. Ct. 23, 45 L. Ed. 79): "The effect of such a provision, whether contained in an original act of incorporation, or in a constitution or general law, subject to which a charter is accepted, is, at the least, to reserve to the legislature the power to make any alteration or amendment of a charter subject to it, which will not defeat or substantially impair the object of the grant, or any right vested under the



grant, and which the legislature may deem necessary to carry into effect the purpose of the grant, or to protect the rights of the public or of the corporation, its stockholders or creditors, or to promote the due administration of its affairs." This case shows that it is immaterial whether the power to alter the charter is reserved in the original act of incorporation, or in the articles of association under a general law, or in a constitution in force when the incorporation under a general law is made, as in the case at bar. Second. It is said that in the Wright Case the change was made by the majority of the members of the association, while in the case at bar it was made by a majority of the directors without the consent of the members. But in each case the change was made in conformity with the provisions of the law authorizing it, and, if the legislature has the constitutional power to authorize the change by the vote of a majority of the members, it has the power to authorize the change by a vote of a majority of the directors. The rights of a protesting member are no more impaired in one case than in the other. Next, it is said that distinctions may be based upon the allegations in this case that the association was insolvent, and that, knowing this, its officers devised the scheme of reincorporation and procured legislation authorizing it, with the intent to defraud the members. That the corporation was solvent was emphasized by the court in the Wright Case, but nothing in the decision of the constitutional question turned upon that. It would introduce a new uncertainty into the law if the constitutionality of statutes were to be judged by the motives and purposes of those who persuaded the legislature to enact them. We are unable to conceive of any possible bearing that these allegations, if accepted as true, could have on the constitutional questions certified to us, or to regard them as creating any real and substantial distinction between the case before us and the Wright Case. On the authority of that case, therefore, the second question must be answered in the negative.

The other two questions certified inquire whether the law under which the reincorporation was made, or the reincorporation and changes in power made under its provisions, are in violation of the Fourteenth Amendment to the Constitution of the United States. These questions do not require separate or detailed consideration. As applied to the facts of this case, they are practically dealt with in the discussion which has preceded. It is not suggested that any rights secured to the complainants by the Fourteenth Amendment were violated in any other manner than by the reincorporation of the association without the consent of its members, the change in and addition to its powers, and the consequent effect upon the contract rights of the complainants and upon their relation to the corporation. But it has been shown that the contract rights of the complainants have not been affected by the reincorporation, and the same reasoning that leads to the conclusion that the changes in the charter powers, made under the re-

served powers of the state, do not violate the contract clause of the Constitution, is apt to show that they do not violate the Fourteenth Amendment. In fact, the only suggestion of a violation of the Fourteenth Amendment made to us is that the reincorporation, under the circumstances of this case, deprived the complainants of their vested rights and privileges and property rights under their contracts, without due process of law. Since the incorporation has deprived the complainants of no vested rights, privileges, or property, the contention fails.

The whole argument of the complainants upon these constitutional questions, though enveloped in many words and presented in divers forms, rests upon a single proposition. That proposition is that they, having become members of an association insuring lives upon the co-operative and assessment plan, and being therefore, in a sense, both insurers and insured, have a vested right that the association shall not, without their consent, engage in other kinds of insurance, which may and probably will indirectly affect, for better or worse, their relations to it. The trouble with this proposition is that it was made and denied in the Wright Case.

We have confined our consideration strictly to the constitutional questions certified. It may be that the complainants' rights under their contracts have not been observed by the company or that they have otherwise been unlawfully injured. These questions are not before us.

The questions are severally answered in the negative.

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#### IV. Taxation of Corporations \*

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##### HAWLEY v. CITY OF MALDEN.

(Supreme Court of the United States, 1914. 232 U. S. 1, 34 Sup. Ct. 201, 58 L. Ed. 477.)

In Error to the Superior Court of the State of Massachusetts to review a judgment in favor of defendant in an action to recover back taxes paid under protest, entered pursuant to the direction of the Supreme Judicial Court of that state after a demurrer to the declaration had been sustained by the Superior Court. Affirmed.

Mr. JUSTICE HUGHES delivered the opinion of the court:

The plaintiff in error, a resident of the city of Malden, brought this action to recover the amount of certain taxes which he had paid under protest. The taxes were assessed upon shares which he held in foreign

\* For discussion of principles, see Clark on Corp. (3d Ed.) §§ 79-81.

corporations most of which did no business and had no property within the state of Massachusetts. It was alleged that the levy and collection were in violation of the due process and equal protection clauses of the Fourteenth Amendment. Demurrer to the declaration was sustained by the superior court, and the case was reported to the supreme judicial court of the commonwealth, which directed judgment for the defendant. 204 Mass. 138, 90 N. E. 415.~

It is conceded that the objection that the statute authorizing the tax (Rev. Laws [Mass.] chap. 12, §§ 2, 4, 23) denies to the plaintiff in error the equal protection of the laws is not well taken; but it is contended that the shares were not within the jurisdiction of the state, and hence that the enforcement of the tax constitutes an unconstitutional deprivation of property.

The power thus challenged, as the state court points out, has been continuously exercised by the state of Massachusetts for more than three quarters of a century. Substantially the same statutory provision, derived from an earlier enactment, is found in Rev. Stat. (Mass.) chap. 7, § 4, and its constitutionality has been sustained by repeated state decisions. *Great Barrington v. Berkshire County*, 16 Pick. (Mass.) 572; *Dwight v. Boston*, 12 Allen (Mass.) 316, 90 Am. Dec. 149; *Frothingham v. Shaw*, 175 Mass. 59, 61, 55 N. E. 623, 78 Am. St. Rep. 475. And other states through a long period of years have asserted a similar authority. *Union Bank v. State*, 9 Yerg. (Tenn.) 490; *McKeen v. Northampton County*, 49 Pa. 519, 88 Am. Dec. 515; *Whitesell v. Northampton County*, 49 Pa. 526; *State, Fish, Prosecutor, v. Branin*, 23 N. J. Law, 484; *State, Vail, Prosecutor, v. Bentley*, 23 N. J. Law, 532; *Worthington v. Sebastian*, 25 Ohio St. 1; *Bradley v. Bauder*, 36 Ohio St. 28, 38 Am. Rep. 547; *Dyer v. Osborne*, 11 R. I. 321, 23 Am. Rep. 460; *Seward v. Rising Sun*, 79 Ind. 351; *Ogden v. St. Joseph*, 90 Mo. 522, 3 S. W. 25; *Worth v. Ashe County*, 90 N. C. 409; *Jennings v. Com.*, 98 Va. 80, 34 S. E. 981; *Appeal Tax Ct. v. Gill*, 50 Md. 377; *State v. Nelson*, 107 Minn. 319, 119 N. W. 1058; *Bacon v. State Tax Com'rs*, 126 Mich. 22, 60 L. R. A. 321, 86 Am. St. Rep. 524, 85 N. W. 307; *State v. Kidd*, 125 Ala. 413, 28 South. 480; *Com. v. Lovell*, 125 Ky. 491, 101 S. W. 970; *Stanford v. San Francisco*, 131 Cal. 34, 63 Pac. 145; *Judy v. Beckwith*, 137 Iowa, 24, 15 L. R. A. (N. S.) 142, 114 N. W. 565, 15 Ann. Cas. 890; *Greenleaf v. Morgan County*, 184 Ill. 226, 75 Am. St. Rep. 168, 56 N. E. 295. It is well settled that the property of the shareholders in their respective shares is distinct from the corporate property, franchises and capital stock, and may be separately taxed (*Van Allen v. Assessors* [Churchill v. Utica] 3 Wall. 573, 584, 18 L. Ed. 229, 234; *Farrington v. Tennessee*, 95 U. S. 679, 687, 24 L. Ed. 558, 560; *Tennessee v. Whitworth*, 117 U. S. 129, 136, 137, 29 L. Ed. 830, 832, 6 Sup. Ct. 645; *New Orleans v. Houston*, 119 U. S. 265, 277, 30 L. Ed. 411, 415, 7 Sup. Ct. 198); and the rulings in the state cases which we have cited proceed upon the view that shares are personal property, and, having no situs else-



where, are taxable by the state of the owner's domicile, whether the corporations be foreign or domestic.

It is said that the question of the constitutional validity of such taxation has not hitherto been raised definitely in this court and has not been directly passed upon. There is no doubt, however, that the existence of the state authority has invariably been assumed. In *Sturges v. Carter*, 114 U. S. 511, 29 L. Ed. 240, 5 Sup. Ct. 1014, the action was brought to recover taxes imposed under the law of Ohio upon shares of stock owned by a resident of Ohio in the Western Union Telegraph Company, a New York corporation. The right of the state to tax the shares was not questioned, and as it was found that a statutory exemption which was relied upon in defense did not apply, the recovery of the tax was sustained. Again, in *Kidd v. Alabama*, 188 U. S. 730, 47 L. Ed. 669, 23 Sup. Ct. 401, it was not disputed that the state was entitled to tax shares owned by its citizens in foreign corporations. The argument was that the statute in that case created an unconstitutional discrimination, and this point being found to be without merit, the tax was upheld. In *Wright v. Louisville & N. R. Co.*, 195 U. S. 219, 49 L. Ed. 167, 25 Sup. Ct. 16, the question was whether shares of stock in a railroad corporation of another state, which were owned by a Georgia corporation, were taxable under the Constitution and laws of Georgia. The state's power to tax the shares was not denied, so far as the Constitution of the United States was concerned, but it was contended that this power had not been exercised. The Constitution of Georgia provided that all taxation should "be uniform upon the same class of subjects, and ad valorem on all property subject to be taxed within the territorial limits of the authority levying the tax," and should be levied and collected under general laws. The general tax act had authorized a tax on all of the taxable property of the state. It was clear that the state had directed shares in foreign corporations to be taxed, provided these could be considered to be "property subject to be taxed within the territorial limits" of the taxing authority. And such shares, when held by a resident, being deemed to fall within this description, it was decided that the state officer was entitled to collect the tax. "Putting the case at the lowest," said the court, "the above-cited section of the Constitution was adopted in the interest of the state as a tax collector, and authorizes, if it does not require, a tax on the stock." So, also, in *Darnell v. Indiana*, 226 U. S. 390, 57 L. Ed. 267, 33 Sup. Ct. 120, the authority of the state to tax the shares of its citizens in foreign corporations was recognized, the tax being sustained against objections urged under the commerce clause, art. 1, § 8, and the equal protection clause of the Fourteenth Amendment.

To support the contention that this familiar state action, hitherto assumed to be valid, is fundamentally violative of the Federal Constitution, the plaintiff in error invokes the doctrine that a state has no right to tax the property of its citizens when it is permanently located in another jurisdiction. *Louisville & J. Ferry Co. v. Kentucky*, 188 U.

S. 385, 47 L. Ed. 513, 23 Sup. Ct. 463; Delaware, L. & W. R. Co. v. Pennsylvania, 198 U. S. 341, 49 L. Ed. 1077, 25 Sup. Ct. 669; Union Refrigerator Transit Co. v. Kentucky, 199 U. S. 194, 50 L. Ed. 150, 26 Sup. Ct. 36, 4 Ann. Cas. 493. But these decisions did not involve the question of the taxation of intangible personal property (Union Refrigerator Transit Co. v. Kentucky, *supra*, p. 211); nor do they apply to tangible personal property which, although physically outside the state of the owner's domicil, has not acquired an actual situs elsewhere. Southern P. Co. v. Kentucky, 222 U. S. 63, 68, 56 L. Ed. 96, 98, 32 Sup. Ct. 13. When we are dealing with the intangible interest of the shareholder, there is manifestly no question of physical situs, so far as this distinct property right is concerned, and the jurisdiction to tax it is not dependent upon the location of the lands and chattels of the corporation.

The argument, necessarily, is that shares are to be deemed to be taxable solely in the state of incorporation. It is urged that these rights rest in franchise, and that the principle of the decision in Louisville & J. Ferry Co. v. Kentucky, *supra*, holding that a ferry franchise granted by Indiana to a Kentucky corporation was not taxable in Kentucky, is applicable to shares of stock. But that case went upon the ground that the franchise was an incorporeal hereditament, and hence had its legal situs in Indiana, 188 U. S. 398, 23 Sup. Ct. 463, 47 L. Ed. 513. Shares fall within a different category. While the shareholder's rights are those of a member of the corporation entitled to have the corporate enterprise conducted in accordance with its charter, they are still in the nature of contract rights or choses in action. Morawetz, Priv. Corp. § 225. As such, in the absence of legislation prescribing a different rule, they are appropriately related to the person of the owner, and, being held by him at his domicil, constitute property with respect to which he is under obligation to contribute to the support of the government whose protection he enjoys. Kirtland v. Hotchkiss, 100 U. S. 491, 25 L. Ed. 558; Bonaparte v. Appeal Tax Ct., 104 U. S. 592, 26 L. Ed. 845; Covington v. First Nat. Bank, 198 U. S. 100, 111, 112, 49 L. Ed. 963, 968, 969, 25 Sup. Ct. 562; Southern P. Co. v. Kentucky, *supra*; Cooley, Tax'n (3d Ed.) 26.

Undoubtedly, the state in which a corporation is organized may provide, in creating it, for the taxation in that state of all its shares, whether owned by residents or nonresidents. Corry v. Baltimore, 196 U. S. 466, 49 L. Ed. 556, 25 Sup. Ct. 297. This is by virtue of the authority of the creating state to determine the basis of organization and the liabilities of shareholders. *Id.*, 196 U. S. 476, 477, 25 Sup. Ct. 297, 49 L. Ed. 556; Hannis Distilling Co. v. Baltimore, 216 U. S. 285, 293, 294, 54 L. Ed. 482, 485, 486, 30 Sup. Ct. 326. So, by reason of its dominant power to provide for the organization and conduct of national banks, Congress has fixed the places at which alone shares in those institutions may be taxed. Rev. Stat. § 5219, U. S. Comp. Stat. 1901, p. 3502. Whether, in the case of corporations organized under

state laws, a provision by the state of incorporation, fixing the situs of shares for the purpose of taxation, by whomever owned, would exclude the taxation of the shares by other states in which their owners reside, is a question which does not arise upon this record and need not be decided. No such provision is here involved, and the present case must be determined by the application of the established principle which has been stated.

The real ground of complaint in this class of cases is not that the shares are taxed in one place rather than in another, but that they are taxed at all, when presumably the property and franchises of the corporation which give to the shares their value are also taxed. As to this we may repeat what was said in Kidd v. Alabama, supra: "No doubt it would be a great advantage to the country and to the individual states if principles of taxation could be agreed upon which did not conflict with each other, and a common scheme could be adopted by which taxation of substantially the same property in two jurisdictions could be avoided. But the Constitution of the United States does not go so far."

The judgment is affirmed.

Affirmed.



## DISSOLUTION OF CORPORATIONS

I. How Dissolution is Effected<sup>1</sup>

## BOSTON GLASS MANUFACTORY v. LANGDON.

(Supreme Judicial Court of Massachusetts, 1834. 24 Pick. 49, 35 Am. Dec. 292.)

Action in assumpsit by plaintiff, Glass Company, upon note given by defendant to plaintiff. Plea in abatement that there was no such corporation. The facts showed incorporation in 1811, an assignment of all the corporate property in 1817 for the benefit of corporate creditors, and an omission to hold meetings, elect directors or transact business since then. The jury was instructed that the corporate life continued, and found for the plaintiff. The instructions are assigned as reversible error.

MORTON, J.<sup>2</sup> \* \* \* The legal establishment and due organization of the corporation were admitted; but it was contended that the facts disclosed showed a dissolution of it.

The elementary treatises on corporations describes four methods in which they may be dissolved. It is said that private corporations may lose their legal existence by the act of the legislature; by the death of all the members; by a forfeiture of their franchises; and by a surrender of their charters. 2 Kyd, Corp. 447; 1 Bl. Comm. 485; 2 Kent's Comm. (1st Ed.) 245; Angell and Ames Corp., 501; Oakes v. Hill, 14 Pick. 442. No other mode of dissolution is anywhere mentioned or alluded to.

1. In England, where the parliament is said to be omnipotent, and where in fact there is no constitutional restraint upon their action, but their own discretion and sense of right, corporations are supposed to hold their franchises at the will of the legislature. But if they possess the power to annul charters, it certainly has been rarely exercised by them. In this country, where the legislative power is carefully defined by explicit fundamental laws, by which it must be governed and beyond which it cannot go, it has become a question of some difficulty to determine the precise extent of their authority in relation to the revocation of charters granted by them. But as it is not pretended that there has been any legislative repeal of the plaintiff's charter, it will not be useful further to discuss this branch of the subject.

2. As all the original stockholders are not deceased, the corporation cannot be dissolved for the want of members to sustain and exercise

<sup>1</sup> For discussion of principles, see Clark on Corp. (3d Ed.) § 82.

<sup>2</sup> The statement of facts is rewritten and portions of the opinion are omitted.

the corporate powers. Besides, this mode of dissolution cannot apply to pecuniary or business corporations. The shares, being property, pass by assignment, bequest or descent, and must ever remain the property of some persons, who of necessity must be members of the corporation as long as it may exist.

3. Although a corporation may forfeit its charter by an abuse or misuser of its powers and franchises, yet this can only take effect upon a judgment of a competent tribunal. 2 Kent's Comm. (1st Ed.) 249; *Corporation of Colchester v. Seaber*, 3 Burr. 1866; *Smith's Case*, 4 Mod. 53. Whatever neglect of duty or abuse of power the corporation may have been guilty of, it is perfectly clear that they have not lost their charter by forfeiture. Until a judicial decree to this effect be passed, they will continue their corporate existence. *The King v. Amery*, 2 T. R. 515.

4. Charters are in many respects compacts between the government and the corporators. And as the former cannot deprive the latter of their franchises in violation of the compact, so the latter cannot put an end to the compact without the consent of the former. It is equally obligatory on both parties. The surrender of a charter can only be made by some formal solemn act of the corporation; and will be of no avail until accepted by the government. There must be the same agreement of the parties to dissolve that there was to form the compact. It is the acceptance which gives efficacy to the surrender. The dissolution of a corporation, it is said, extinguishes all its debts. The power of dissolving itself by its own act would be a dangerous power, and one which cannot be supposed to exist.

But there is nothing in this case which shows an intention of the corporators to surrender or forfeit their charter, nor anything which can be construed into a surrender or forfeiture.

The possession of property is not essential to the existence of a corporation. 2 Kent's Comm. (1st Ed.) 249. Its insolvency cannot, therefore, extinguish its legal existence. Nor can the assignment of all its property to pay its debts, or for any other purpose, have that effect. The instrument of assignment was not so intended, and cannot be so construed. All its provisions look to the continuance of the corporation. It contains covenants that the assignees may use the corporate name for the collection of the debts and the disposition of the property assigned; that the corporation will not hinder or obstruct them in the performance of these functions; that it will make any further conveyances and assurances which may become necessary, and will do and perform any other and further acts which may be required to enable the assignees fully to execute their trust. The instrument which covenants for future acts cannot be construed to take away all power of action.

The omission to choose directors clearly does not show a dissolution of the corporation. Although the proper officers may be necessary to

enable the body to act, yet they are not essential to its vitality. Even the want of officers and the want of power to elect them, would not be fatal to its existence. It has a potentiality which might, by proper authority, be called into action without affecting the identity of the corporate body. *Colchester v. Seaber*, 3 Burr. 1870.

But here in fact was no lack of officers. Although no directors had been chosen for several years, yet by the by-laws of the corporation the directors, though chosen for one year, were to continue in office till others were chosen in their stead. \* \* \*

Affirmed.

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### BOWDITCH v. JACKSON CO.

(Supreme Court of New Hampshire, 1912. 76 N. H. 351, 82 Atl. 1014, Ann. Cas. 1913A, 366.)

Bill in equity by Charles P. Bowditch and others against the Jackson Company and others to enjoin a sale of the assets of the Jackson Company. Case discharged.

The plaintiffs are stockholders of the Jackson Company, and allege in their bill that, through control exercised by common directors, the defendants were about to execute a conspiracy to sell the assets of the Jackson Company to the Nashua Company, for an inadequate price, payable in Nashua Company stock; that in furtherance of this conspiracy, the officers had procured the assent of the holders of 460 of the 600 shares of Jackson Company stock to a trust agreement, whereby they were irrevocably bound for one year to vote for the sale; and that a meeting of the stockholders had been called to consider the proposed action. In the superior court, Wallace, C. J., ordered the injunction, but later so far modified it as to permit holding the meeting and passing the votes as to the sale; the same to be effective if the injunction is hereafter dissolved. The hearing on the merits was had before Plummer, J., who reported the facts and transferred the case without ruling, from the May term, 1911, of the superior court. In the fall of 1910 committees of the boards of directors of the two companies were appointed to consider the advisability of the sale and purchase. They reported recommending such sale on the basis of the Nashua Company paying in its own stock at the rate of  $1\frac{1}{2}$  shares of \$500 par value for each share of Jackson Company stock of \$1,000 par value. After this recommendation was made, holders of 466 shares of Jackson Company stock entered into a trust agreement whereby their stock was transferred to certain trustees to hold the same for one year, to vote it for the proposed sale, and to distribute the proceeds of the sale and take necessary steps to wind up the company. Aside from these particulars, the trustees were left free to exercise their judgment in voting the stock, but were to make no substantial change in the business or condition of the corporation, except as above specified.



After the injunction was modified, a meeting of Jackson Company stockholders was held, at which it was voted (subject to the injunction proceedings) to make the sale and wind up the company, to sell the stock of the Nashua Company not taken by Jackson Company stockholders, and to distribute the proceeds among them. At this meeting 490 shares were voted in favor of the sale and 104 against it. Of the 490 shares, 446 were voted by the trustees and the balance by individual holders or their proxies. The plaintiffs protested the legality of the action. The market value of the Jackson Company stock has been and is \$975 a share, and that of the Nashua Company stock, \$650. After the sale was voted, a standing offer was secured from the American Trust Company of Boston to take the Nashua Company stock not taken by Jackson Company stockholders at \$650 a share. The price to be paid to the Jackson Company stockholders is adequate, and the proposed exchange of stock is equitable. The officers, directors, trustees, and attorneys who were engaged in promoting the sale have acted in good faith and for the best interests of both companies, according to the best of their judgment. All the terms of the proposed transaction are fair and equitable.

PEASLEE, J.<sup>s</sup> 1. The main question in this case is whether a going business corporation can be closed out and dissolved upon the motion of the majority of its stockholders and against the protest of the minority. The question is a new one in this state, although it has frequently been considered (both in cases where it was necessarily involved and those where it was not) by the courts in other states. The decisions and dicta are conflicting and are quite evenly divided. In the following cases the existence of the power is denied, though in most of them the question was not necessarily involved: *Abbot v. Rubber Co.*, 33 Barb. (N. Y.) 578; *People v. Ballard*, 134 N. Y. 269, 32 N. E. 54, 17 L. R. A. 737; *Kean v. Johnson*, 9 N. J. Eq. 401; *Forrester v. Mining Co.*, 21 Mont. 544, 55 Pac. 229, 353. That the power exists is decided or declared in other cases. *Treadwell v. Company*, 7 Gray (Mass.) 393, 66 Am. Dec. 490; *Phillips v. Company*, 21 R. I. 302, 43 Atl. 598, 45 L. R. A. 560; *Black v. Canal Co.*, 22 N. J. Eq. 130, 404 (overruling *Kean v. Johnson*, 9 N. J. Eq. 401); *Merchants', etc., Line v. Wagner*, 71 Ala. 581; *State v. Company*, 115 Tenn. 266, 89 S. W. 741, 2 L. R. A. (N. S.) 493, 112 Am. St. Rep. 825; *Tanner v. Railway*, 180 Mo. 1, 79 S. W. 155, 103 Am. St. Rep. 534; *Arents v. Company* (C. C.) 101 Fed. 338. The only case in this state having a direct bearing upon the subject is *Dow v. Railroad*, 67 N. H. 1, 36 Atl. 510. In that case there was an attempt to change the business of the corporation; and while any expression of opinion on the question here involved was carefully avoided, yet the opinion of Chief Justice Doe contains an exhaustive and illuminating discussion of the nature of a corporation and the source of the power of the majority to act for it. The ma-

\* A portion of the opinion and all of the opinion on rehearing are omitted.

jority have the agency which in a partnership each partner possesses. Do they, in addition thereto, have the power each partner has to compel a dissolution? The corporation being an outgrowth of the law of partnership, it would be reasonable to expect that so important an incident to the joint undertaking as the right to terminate the enterprise would not be lost by the change in the form of the association.

The fiction that the corporation is a being independent of those who are associated as its stockholders is not favored in this state. *Dow v. Railroad*, supra, 67 N. H. 3, 36 Atl. 510. Decisions based upon the idea that there is something sacred in the life of an ordinary business corporation, so that action looking to its extermination is in the nature of a fraud upon the state (*People v. Ballard*, 134 N. Y. 269, 32 N. E. 54, 17 L. R. A. 737), are not authority in a jurisdiction where a different view of the nature of the association is entertained. The question is not one of power granted by the state. It relates solely to the agreement of individuals with each other.

Did the stockholders who united to form the Jackson Company in 1830 understand that the business must be continued perpetually, provided a profit could be made and some stockholder objected to closing it out, or did they understand that the enterprise could be brought to an end at such time as the majority believed to be for the best interest of all concerned? The latter seems the more reasonable and probable conclusion.

Much has been said in the cases upholding the right of the minority to prevent a sale and dissolution concerning the protection of their rights and saving their property from pillage by the majority. Just how the majority, which sells its own property at the same time and for the same price it sells that of the minority, gains an advantage over the latter is not readily apparent. Cases might be supposed, and undoubtedly occur, where the majority do obtain some undue advantage from the sale. No one contends that such a sale is valid. But because the power of the majority may be abused, it does not follow that it does not exist. If such a conclusion were to be drawn, minorities would always rule. The plain common sense of the matter is that this is a business venture, to be carried on as such so long as it appears to be good business judgment to do so. When the time comes that a majority in interest believe that their affairs should be wound up and the proceeds distributed, the rational rule is that this should be done. And since the question here is of a business nature, and the limitations of the power of the majority are fixed by the understanding of the business men who made the original compact, business considerations have more than ordinary weight in determining what the contract was.

It is admitted on all sides that the majority may sell out if the corporation is insolvent. And when brought face to face with the question whether they must wait until the stockholders' investment is all lost before taking action, the conclusion has been that if insolvency is imminent action may be taken. And the same is true if it is impru-

dent to continue. 4 Thomp. Corp. § 4489, and authorities cited. One reason only is given why the power exists in these cases: It is reasonable to suppose that such authority was contemplated, because this is what sound business judgment dictates should be done. The difference between these cases and the present one is of degree only, not of kind. The majority are not obliged to wait until all possibility that the corporation can go on longer has been negatived. Some of the cases have stated that such is the rule; but the result of this would be to compel the majority to continue a losing business until their investment was entirely wiped out. To avoid so absurd a result, it has been said they could close out when insolvency seemed to be approaching. And so various forms of expression have been used to indicate the time when the majority could take action.

All these are fairly summed up in the statement that the majority may close out the affairs of the company when it can no longer make a reasonable profit. It is believed no court would now hold that the rights of the minority were more extensive than this rule implies.

If the majority may sell to prevent greater losses, why may they not also sell to make greater gains? Bearing in mind that this is purely a business proposition, with no public rights or duties involved, there seems to be no substantial difference between the two cases, as a matter of principle. In each case the sale is made because it is of advantage to the stockholders. Whether the profit to be made is a reasonable one must be a relative matter. Three per cent. when others make 2 might be reasonable; but 3 per cent. when a sale could be made which would yield the stockholder 10 could hardly be thought an investment a reasonable person would retain. The loss to the stockholder by a failure to sell out on a basis which would yield him 10 per cent. instead of the 3 he is receiving is in fact much greater than it would be if a concern went on neither making nor losing when the investment would earn 4 per cent. elsewhere. It does not seem reasonable that the majority should have power to make a sale in the latter case, and not in the former. In neither case would the sale prevent positive loss, but in each it would result in positive gain. And the question is one of future prospects. Its decision requires the exercise of business judgment, sagacity, and power to forecast coming events. It is not an issue appropriate for trial and decision in courts, but rather one to be settled by the judgment of the men conducting the business in question. In a limited sense, the majority act as trustees for all the stockholders. When their acts are impugned by the minority, it is not the function of the court to set its judgment against theirs in settling the wisdom or policy of proposed action. By the contract of association, all questions of this nature were committed to the majority for final decision. *Gamble v. Water Co.*, 123 N. Y. 91, 99, 25 N. E. 201, 9 L. R. A. 527.

The whole difficulty is probably an outgrowth of the early idea that a corporation possessed peculiar attributes of longevity and sanctity. But as pointed out in *Dow v. Railroad*, 67 N. H. 1, 8, 26, 36 Atl. 510,



no such theory prevails here. The business corporation is brought into being solely for the purpose of more conveniently carrying out the joint undertaking of the part owners. The line of distinction between this form of association and certain partnerships is but a shadowy one. It is not reasonable or natural to expect that when this boundary is passed great changes in the relation of the parties will result. A more radical change than that here claimed could not easily be imagined. In the partnership, one partner may compel a winding up from mere whim. In the absence of an agreement to go on for a fixed period of time, nothing short of a fraudulent purpose will prevent his taking valid action to close out the firm at will. *Fletcher v. Reed*, 131 Mass. 312; Lind. Part. \*570. By the rule here contended for, the change of the association into a corporation has carried the rule to the opposite extreme. The authority to wind up is lost, and the owner of the smallest share may prevent such action, though it is desired by all his associates. The practical reasons against such a proposition are apparent. The probabilities are opposed to the idea that the associates intended to enter into such a compact.

It is urged that the analogy of the partnership right does not apply, because the stockholder can sell his shares and so terminate his connection with a management with which he is dissatisfied. It is true he has this legal right; but it is not true that it is an adequate remedy, when a majority desire to retire from the business. The proposition is a practical one. It is not disposed of by offering to the majority a naked legal right the exercise of which will probably deprive them of a considerable share of their property. Partnerships are sometimes formed with transferable shares, but this does not impair the right to compel a dissolution. In the case of special or limited partnerships, the rule is that the general law of partnership applies, unless modified by statute or special agreement. *Tyrrell v. Washburn*, 6 Allen (Mass.) 466. Accordingly, it was held that where shares in the firm were transferable, and additional shares were issued from time to time, a partner who wished to retire could compel a dissolution and winding up of the firm. *Id.* The fact that (as in a corporation) the dissatisfied owner could sell his shares was not sufficient to take away his right to other remedies.

The action taken by a majority of the stockholders of the Jackson Company whereby, as a part of the process of winding up the company, they voted to sell all its property to the Nashua Company, was within the power impliedly given to them when the company was formed. The charges that there was fraud in the sale and that it was for an inadequate price have been disproved. \* \* \*

Case discharged. All concurred.

## II. Death or Loss of Members <sup>4</sup>

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### FIRST NATIONAL BANK OF GADSDEN v. WINCHESTER.

(Supreme Court of Alabama, 1898. 119 Ala. 168, 24 South. 351,  
72 Am. St. Rep. 904.)

HEAD, J.<sup>5</sup> The Gadsden Foundry & Machine Works was organized as a body corporate under our general incorporation laws. On March 1, 1887, its only stockholders were J. E. Line, S. M. Winchester, John Flinn and William Hagen. On that day, Line and Winchester sold and assigned all their stock in the corporation to their co-stockholders, Flinn and Hagen, at the agreed price of \$7,750, to be paid in the future, for which seventeen promissory notes, maturing at different times, were given. These notes were not only executed by the purchasers, Flinn and Hagen, but by the corporation also, by and through Flinn, as president, and Hagen, as secretary. To secure them, Flinn, Hagen, their wives and the corporation (the latter acting in its corporate name, by Flinn as president and Hagen as secretary), at the same time executed a mortgage on certain described real and personal property belonging to the corporation, with power of sale, etc. This mortgage recited that Flinn and Hagen were the only stockholders of the corporation. December 4, 1891, the said Gadsden Foundry & Machinery Works, to secure an indebtedness of \$5,000, evidenced by four described promissory notes then made by it to A. L. Glenn, trustee (the indebtedness being alleged in the bill to have been owing to the complainant), executed to said Glenn, trustee, a mortgage on the same property as that described in said former mortgage, with power of sale, etc.; and on June 25, 1892, executed another mortgage on a part of the property to the complainant to secure an additional indebtedness of \$1,250.

The mortgage of March 1, 1887, to Line and Winchester, was foreclosed under the power and the mortgagees therein became the purchasers, and have possession of the property as such purchasers. The bill is filed against the corporation and the said Line and Winchester, by the said second mortgagee praying cancellation of said first mortgage and of the foreclosure thereof; asking foreclosure of its own mortgages, and for general relief.

The respondents, Line and Winchester, moved to dismiss the bill for want of equity, which motion was sustained and the bill dismissed. \* \* \*

The question then is, what interest had Flinn and Hagen in the property which by law they were competent to transfer as security

<sup>4</sup> For discussion of principles, see Clark on Corp. (3d Ed.) § 82.

<sup>5</sup> Portions of the opinion are omitted.

for their individual debt, and what the relative rights of their mortgagees and the said subsequent encumbrancers, with notice, created by the corporation itself acting within its charter powers?

As we have seen, Flinn and Hagen, when they executed the notes and mortgages now assailed, were the only stockholders of the corporation, and there were no creditors or other parties in interest to be affected. It was purely a private business corporation, organized solely for the profit of the stockholders, and in nowise to serve the public.

There seems to be no contrariety of opinion among text-writers and courts to the effect that the shareholders of private business corporations, where there are no creditors or others interested, are the beneficial owners of the corporate property. Morawetz, an authority of distinction on this branch of the law, says: "A private corporation is in reality a voluntary association, formed by agreement of its members for the purposes set forth in their charter. The real or beneficial ownership of everything belonging to an ordinary trading corporation is in the persons who compose it. Each stockholder has an equitable interest in the corporate affairs; and this interest must be managed in accordance with the provisions of the charter, by the agents appointed to act for the whole association. The courts of law, however," he says, "recognize a corporation only as one body, acting in the corporate name. The individual stockholders are not, in contemplation of law, parties to contracts made by the association in a corporate capacity, nor have they any legal right or title to property vested in the corporation. At law, a corporation and its stockholders are considered as distinct from each other and the contractual relation between the stockholders is wholly ignored. It thus appears that the courts of law are, in many cases, unable to protect the rights of stockholders of a corporation, and that the assistance of chancery is necessary to the attainment of justice. The relation between a corporation and its several members," he continues, "may, for all practical purposes, be treated as that of trustee and cestui que trust. In contemplation of law the property and rights of an incorporated association belongs to the united association acting in the corporate name, and not to its stockholders. The latter, however, are the real owners; and a technical trust thus arises in their favor, which will be enforced by the courts of equity."

The principles here stated that the legal title to the property of the corporation is in the corporation itself and not the shareholders cannot, of course, be questioned, and the authorities, for the most part, go so far as to hold that even when the body ceases to be an association of persons by reason of the concentration of all the stock in the hands of one owner, the corporation is not thereby dissolved, and the sole stockholder does not thereby become legal owner of the property. *Button v. Hoffman*, 61 Wis. 20, 20 N. W. 667, 50 Am. Rep. 131. There being, with us, no such entity as a corporation sole, the corporate body



when reduced to one stockholder, is said to be in abeyance merely, ready to resume active functions whenever by transfers of shares to others by the sole owner, it becomes again a body aggregate. It is abeyance, not dissolution and restoration to the shareholder of legal ownership. *Louisville Banking Co. v. Eisenman*, 94 Ky. 83, 21 S. W. 531, 1049, 19 L. R. A. 684, 42 Am. St. Rep. 335; *Cook on Stock* (2d Ed.) § 631; *Mor. on Corp.* 635.

But now we are in a court of equity inquiring of equitable ownership. It seems to us to be logically necessary that Morawetz and other authors and courts should hold to the doctrine that a corporation of the nature of this is the legal representative of those who contribute the capital, or their successors, holding and managing for their private use and benefit, and that the latter (there being no creditor or other holder of a superior right to be consulted) are necessarily equitable owners of the corporate property. It is true, that for the purposes of the charter, the corporation is the legal and equitable proprietor. If to enforce a right, or redress a wrong in respect of corporate property, a resort to a court of equity be essential, the corporation itself may sue in that forum and the presence of the stockholders before the court is not required. The corporation represents the entire estate. But, that presupposes a case where no antagonistic relation to the corporation, set up by the unanimous act of the stockholders, is the subject-matter of investigation. A conflict of that character presents a different question. We are, in that case, required to consider how far the unanimous voice of the stockholders may modify or control corporate action in reference to the management and disposition of corporate property. Such is the question here presented. All the stockholders mortgaged the property to secure their debt, and the substantial, beneficial ownership being necessarily in them and held by the artificial creature of the law, the corporation, for their exclusive behoof, we hold that their conveyance passed that interest against the equitable demands of subsequent purchasers or incumbrancers with notice from the corporation. We have, in support of this conclusion, an elaborate discussion, leading to the same result, by the Court of Appeals of Maryland, in *Swift v. Smith*, 65 Md. 428, 5 Atl. 534, 57 Am. Rep. 336. It was there held that a purchaser of shares of stock from one who owned all the stock of the company, was bound in equity by a mortgage executed by the sole owner while such, upon the corporate property. At the time *Flinn and Hagen* executed the mortgage assailed, being the only parties interested, they had the right to procure at once without the power of successful resistance from any source, a dissolution of the charter and restoration of themselves to the legal ownerships. Such dissolution was necessary only as it concerned the legal ownership. They already had the beneficial estate, and having it, could dispose of it. Mr. Thompson, in his work on Corporations, approves *Swift v. Smith*, *supra*, and adds, if the sole owner may convey the corporate property, in equity, no reason is perceived why all the stockholders,

however numerous, may not accomplish the same result by their joint deed. 4 Thomp. Corp. § 5096.

We hold, in equity, the mortgage to Line and Winchester is superior to those of the complainant on the same property. \* \* \*  
Affirmed.

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### III. Effect of Dissolution<sup>6</sup>

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#### STANNARD v. ROBERT H. REID & CO.

(Supreme Court of New York, Appellate Division, First Department, 1906.  
114 App. Div. 135, 99 N. Y. Supp. 567.)

Appeal from Trial Term, New York County.

Action by Ambrose B. Stannard against Robert H. Reid & Co., a corporation. From a judgment dismissing the complaint on the merits, plaintiff appeals. Reversed.

HOUGHTON, J. The plaintiff had a contract with the United States government to erect a courthouse and post-office building in the city of Elmira. The defendant corporation, through its president entered into a contract with him to do the marble work and lay the floors therein. This contract specified that the defendant should so prepare the marble presumably at its factory, for setting, that the entire work might be completed 60 days after notice that the building had so far progressed as to be ready for that part of the work. Before the building had arrived at this stage the defendant corporation went into voluntary dissolution and temporary receivers were appointed who were given by the court, power to complete the contracts of the corporation. Correspondence was had between the plaintiff and the receivers with respect to fulfilling the contract on the part of defendant, which resulted, however, in the receivers giving notice to the plaintiff on the 17th of October, 1902, that they would not complete the contract because it was an undesirable one and liable to result in loss, and in a notice by the plaintiff on the following day that by reason of this default he would relet the contract and hold the defendant for any excess of cost. This he did and brings this action to recover such excess.

The trial court dismissed the plaintiff's complaint on the ground that the appointment of the receivers of the defendant corporation excused and prevented performance by defendant, and relieved it from liability for damages resulting from the breach. It appeared further with respect to the receivership, that on the 7th day of February, 1903, just one year after the receivers were appointed, that the court dis-

<sup>6</sup> For discussion of principles, see Clark on Corp. (3d Ed.) § 85.

charged them upon turning over all of the property of the corporation to it, and vacated and set aside the order appointing them. We think the defendant corporation was not as matter of law prevented or excused from performing the contract in question by the appointment of the receivers in the proceeding for voluntary dissolution, or relieved from liability for damages for its breach. The effect of the voluntary dissolution of a corporation upon its contracts, was exhaustively discussed by this court in *Mason v. Standard Distilling Co.*, 85 App. Div. 520, 83 N. Y. Supp. 343, and it was there held that whether or not such dissolution relieved the corporation from liability upon its contracts was a question of fact to be determined upon all the circumstances attending such dissolution, and the propriety thereof because of its financial condition; and that if a corporation was voluntarily dissolved for the purpose of evading its undesirable contracts and not because of necessity therefor, the act amounted to a fraud and the corporation was estopped from setting up such dissolution as a defense to breach of contracts on its part.

The case of the *People v. Globe Mutual Life Ins. Co.*, 91 N. Y. 174, relied upon by the respondent, is there commented upon, and it is pointed out that it there appeared that the act of dissolution was brought about by the sovereign power, which the corporation could not control, and not by any act of the corporation itself. The same principle is enunciated in *Lorillard v. Clyde*, 142 N. Y. 456, 37 N. E. 489, 24 L. R. A. 113, where the plaintiff was not permitted to recover for breach of contract, because he himself had instigated the action in behalf of the people which brought about the dissolution, and was the responsible cause of it; and hence could not assert that it was not a necessity. So far as appears from the record the proceedings for the dissolution of the defendant were wholly voluntary and not brought about in any particular by the plaintiff. The receivers within a few days after their appointment, obtained authority from the court to carry out the contracts of the corporation, and, presumably proceeded to carry out such as they deemed profitable, repudiating that of plaintiff which they deemed unprofitable. After the receivers had relieved the corporation as they supposed, from its obligation under the unprofitable contract with plaintiff, the property of the corporation was shortly restored to it and the receivers discharged and the order appointing them vacated. This state of facts raises a fair presumption that the financial condition of the corporation did not make its dissolution a necessity, but rather that such dissolution was a temporary expedient for the purpose of relieving it from an undesirable obligation. The mere proof on the part of the defendant that it had been voluntarily dissolved was not sufficient to relieve it from the obligation of its contracts. It was incumbent upon it to go further, and to show that a dissolution was a necessity because of the financial condition of the corporation. This was not done; and hence the dismissal of the plaintiff's complaint was error.



The respondent insists that the contract was not made by one having authority to act for the corporation. The trial court assumed that the contract was properly executed. That question and the others relied upon by the defendant may not again arise, and we deem it unnecessary for us at this time to pass upon them. The case was tried and decided upon the theory that the bare dissolution relieved the corporation from the performance of its contract with plaintiff. Upon that theory the complaint was wrongly dismissed and justice will be best subserved by directing a new trial when all the facts with respect to the dissolution can be developed, and where it can be determined whether or not the dissolution was a necessity, and whether defendant was bound by the contract as originally made, or whether it ratified it, if unauthorized, and if valid and defendant not excused from performance what, if any, damages the plaintiff sustained by the breach.

Judgment reversed, and new trial granted, with costs to appellant to abide event. All concur.

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### ATLANTIC DREDGING CO. v. BEARD.

(Court of Appeals of New York, 1911. 203 N. Y. 584, 96 N. E. 415.)

HAIGHT, J. The defendants had demurred to the complaint, and the granting of a motion for judgment, in effect, overruled the demurrer. The questions certified for our determination are as follows:

(1) Does the complaint state facts sufficient to constitute causes of action?

(2) Upon the facts alleged in the complaint and before obtaining judgment against the corporation, is the corporation a necessary party defendant?

(3) Upon the facts alleged in the complaint, are the stockholders of the W. H. Beard Dredging Company necessary parties defendant in this action, without obtaining judgment against the corporation?

(4) Have the causes of action been improperly united in the complaint?

The complaint alleges four different causes of action, arising out of the rent of a scow, for work, labor, and services in dredging at different times, at the instance and request of the W. H. Beard Dredging Company, in and about the harbor of the city of New York, and for dumping the material dredged. The plaintiff is a domestic corporation, having its principal office and place of business in the borough of Manhattan. The William H. Beard Dredging Company is a foreign corporation, created under the laws of the state of West Virginia, but having an office for the transaction of its business in the borough of Manhattan in the city of New York. The defendants William Beard, Lavinia Beard, and John B. Summerfield were the directors of the William H. Beard Dredging Company, and the defendants

William Beard and Lavinia Beard were copartners composing the firm of William Beard & Co.

After the performance by the plaintiff of the work, labor, and services for the William H. Beard Dredging Company, alleged in the complaint, the William H. Beard Dredging Company dissolved and discontinued business as a corporation, and surrendered to the state of West Virginia its charter and corporate franchise, and duly authorized its existing board of directors, who were the defendants William Beard, Lavinia Beard, and John B. Summerfield, to proceed to pay off and discharge its debts, liabilities, and obligations, and to transfer and set over to William Beard and Lavinia Beard, composing the firm of William Beard & Co., the whole of the property belonging to the corporation. This was done under the law of West Virginia, which is set forth in the plaintiff's complaint, with the provision that "when a corporation shall expire or be dissolved, its property and assets shall, under the order and direction of the board of directors then in office, or the receiver or receivers appointed for the purpose by such circuit court as is mentioned in the fifty-seventh section of this chapter, be subject to the payment of the liabilities of the corporation, and the expenses of winding up its affairs; and the surplus, if any, then remaining, to the distribution among the stockholders according to their respective interests. And suits may be brought, continued or defended, the property, real or personal of the corporation, be conveyed or transferred under the common seal or otherwise, and all lawful acts be done in the corporate name, in like manner and with like effect as before such dissolution or expiration; but so far only as shall be necessary or proper for collecting the debts and claims due to the corporation, converting its property and assets into money, prosecuting and protecting its rights, enforcing its liabilities, and paying over and distributing its property and assets, or the proceeds thereof to those entitled thereto."

We think that, under this statute, the directors in office at the time of the dissolution of the corporation are empowered to collect the assets, pay the liabilities, and distribute the surplus; that in discharging that duty they represent both the corporation and its stockholders; and that, consequently, in an action brought to compel them to discharge their duty, neither the corporation nor the stockholders are necessary parties. Upon the other questions involved in the case we concur in the opinion of Ingraham, P. J., below.

The order of the Appellate Division should be affirmed, with costs, and the questions certified answered, the first in the affirmative, and the rest in the negative.

CULLEN, C. J., and VANN, WERNER, WILLARD BARTLETT, HISCOCK, and CHASE, JJ., concur.

Order affirmed.

## HIGGINSON &amp; DEAN.

(Queen's Bench Division. L. R. [1899] 1 Q. B. Div. 325.)

Appeal by the Attorney-General, on behalf of the Treasury, from the order of the judge of the county court at Liverpool, expunging the proof of the Royal Bank of Liverpool in the bankruptcy of the debtors, Messrs. Higginson & Dean. The bankruptcy took place in the year 1847, and the liabilities of the debtors amounted to nearly £900,000. The Royal Bank of Liverpool proved in the Bankruptcy for £566,000. and Messrs. Littledale, who were respondents to the present appeal, and other creditors, proved for smaller sums. It had recently been ascertained that the bankrupts had been entitled to certain shares in the Leeds & Thirsk Railway Company, the undertaking of which company had been acquired by the North Eastern Railway Company, so that the shares belonging to the bankrupts were exchangeable for shares in the North Eastern Railway Company. The official receiver, as ex officio trustee in the bankruptcy, had recovered for the estate a sum of £6500., the proceeds of these shares, and held that amount as trustee. In the year 1887 an order was made by North, J., under the Companies Acts, dissolving the Royal Bank of Liverpool. Messrs. Littledale, as creditors in the bankruptcy, moved before the county court judge to expunge the proof of the Royal Bank. The judge made an order expunging the proof, and the present appeal was from that order.

WRIGHT, J.<sup>7</sup> \* \* \* Subject to one difficulty I think that the grounds of the learned county court judge's decision cannot be maintained, and that the Crown is entitled to succeed.

From the time of Lord Thurlow's decision in *Middleton v. Spicer*, 1 Bro. C. C. 201, in 1783, it has been an accepted proposition of law that chattels real or personal vested in a person as a mere trustee upon private trusts which have failed are as a general rule held by him as a trustee for the Crown of bona vacantia; and during all the period which has elapsed since that decision no exception from the rule seems to have been established. It has been illustrated by many cases which shew that the possession conferred on the trustee for purposes of jurisdiction or administration gives him no beneficial title, as by occupancy or otherwise, which he can conscientiously set up against the Crown. Such cases are: *Barclay v. Russell*, 3 Ves. 424, at page 430, per Lord Loughborough; *Powell v. Merrett* (1853) 1 Sm. & G. 381, Stuart, V. C.; *Cradock v. Owen* (1854) 2 Sm. & G. 241, Stuart, V. C.; *Read v. Stedman* (1859) 26 Beav. 495, Romilly, M. R.; *Cunnack v. Edwards*, [1896] 2 Ch. 679 C. A. And in *Dyke v. Walford*, 5 Moo. P. C. 434, the right of the Crown as against the ordinary to bona vacantia in cases of intestacy is traced back to very early times.

<sup>7</sup> Portions of the opinion are omitted.



Nor, I think, is there any authority for holding that the Crown is in any worse position in relation to chattels held in trust for a corporation which has become dissolved than in relation to chattels held in trust for a natural person deceased. The same principle seems applicable in both cases. The Courts will not allow a person who has obtained title or possession as a mere trustee of chattels to set up unconscientiously any beneficial title by occupancy, possession, or otherwise. The text-books, such as those of Kyd, Grant, and Lewin, agree, though in some cases with an "it seems," that the Crown is entitled to the personal estate of a dissolved corporation aggregate.

Nor is there any authority for holding that the creditors, other than the dissolved Bank, have any *jus accrescendi*, or of survivorship, entitling them to the share of the creditor who has become extinct without successor or representative. In *Ashley v. Ashley*, 4 Ch. D. 757, where, in a suit for administration, such a claim was made and failed, James L. J. asked why the Crown might not take out representation to the petitioners. 4 Ch. D. at page 763. *Prima facie*, therefore, as it seems to me, the Crown is entitled.

The difficulty is, that as it is argued, on the dissolution of the Bank, not only did its artificial personality come to an end, but the debt due to it from the bankrupts lapsed or was extinguished. The existence of a debt, it is said, imports the existence of two parties to the obligation, and the obligation of the debtors to the bank is not, upon the dissolution of the bank converted into an obligation of the debtors to the Crown. The Bank, therefore, has ceased to be a creditor, and the Crown has not become a creditor; the ground of the proof has gone as completely as if it had never existed, and the proof ought to be expunged, with the consequence that the official receiver is now a trustee of the fund for the remaining creditors, as if there never had been any others. Therefore, it is argued, there is no failure of *cestuis que trustent*, and no property which, for default of any *cestui que trust* to claim it, can be said to be held in trust for the Crown.

The authorities for the proposition that on the dissolution of a corporation aggregate debts due to or from it are extinguished are by no means clear or satisfactory. In 1 Bl. Com. p. 484, and in 2 Kyd on Corporations, p. 516, and in Grant on Corporations, p. 303, such a proposition is stated, but in terms which suggest that no more is meant than that, after the dissolution, the individuals who were members or officers of the corporation cannot sue or be sued in respect of its rights or obligations: and this is all that is established by the cases there cited. "The debts of a corporation" (Blackstone says), "either to or from it, are totally extinguished by its dissolution; so that the members thereof cannot recover or be charged with them, in their natural capacities; agreeable to that maxim of the civil law, *si quid universitati debetur, singulis non debetur; nec, quod debet universitas, singuli debent.*" The American decision in the case of *State Bank v. State*, 1

Blackf. (Ind.) 267, 12 Am. Dec. 234, relies on those authorities as supporting the general proposition, but it does not advert to this qualification, or add new references to authority, and the authorities cited do not in any way support the proposition, except as so qualified. Grant on Corporations (published in 1850), p. 303, is explicit in the same sense as the American case last cited, but does not refer to any authority which, so far as I can see, has any bearing on the matter.

Nor do the old authorities as to the effect of dissolution of municipal or other corporations add anything decisive of the question. In the 17th and 18th centuries corporations aggregate, constituted by charter or letters patent, were numerous, and questions frequently occurred as to the effect upon their rights and obligations of dissolution, revival, and reincorporation, with or without change of name or constitution. Many references to such cases will be found in Anderson's Reports and in *Rex v. Pasmore* (1789) 3 T. R. 199. I cannot find that in any case the rights or obligations of a corporation were held to be affected by a technical dissolution. Nor, on the other hand, can I find a case in which such a question has been decided, where the corporation had not been revived, or some provision made by statute or charter with reference to its obligations. In *Mayor, etc., of Colchester v. Seaber* (1766) 3 Burr. 1866, the revived corporation sued in its own name on a bond given to the dissolved corporation, and succeeded. Sir Fletcher Norton, for the plaintiff corporation, argued that the goods and chattels of the old corporation, including its choses in action such as the bond, had on its dissolution passed to the Crown, and that the Crown in granting a charter of revival had regranted them to the revived corporation. Mr. Dunning, on the other side, neither admitted nor denied this, and the Court is not reported to have expressed any opinion on this point, it being held that there was only a qualified dissolution, and no absolute break of continuity.

Suppose the bank at the time of its dissolution had been in credit at another bank, or held notes of another bank, or had issued notes of its own. Would the dissolution have destroyed the obligations in these cases? In the United States of America there have been two decisions of Story, J., which are against such a conclusion. In *Wood v. Dummer* (1824) 3 Mason, 308, Fed. Cas. No. 17,944, the charter of a bank had expired. Before dissolution the bank had distributed its capital amongst its stockholders, without providing for payment of outstanding notes. It was held that after the dissolution noteholders were entitled to make stockholders account to them, as for moneys impressed with a trust of which the stockholders had notice. In *Mumma v. Potomac Co.* (1834) 8 Pet. 281, 8 L. Ed. 945, it was contended that the dissolution of an insolvent incorporated company, under a statute of the Legislature of a State, was inoperative, as being contrary to the Constitution, which prohibited the impairing of obligations by the Legislatures of particular States. Story, J., however, held that the obligations

were not impaired by the dissolution: "The obligation of those contracts survives; and the creditors may enforce their claims against any property belonging to the corporation, which has not passed into the hands of bona fide purchasers, but is still held in trust for the company, or for the stockholders thereof, at the time of its dissolution, in any mode permitted by the local laws." 8 Pet. at page 286, 8 L. Ed. 945.

This statement of the law may not perhaps be entirely applicable to this country, but it requires consideration. It might be reasonable to enact that, in analogy to the immemorial law of executors and administrators, and the statute of 31 Edw. III, St. 1, c. 11, on the dissolution of a corporation aggregate all its rights, including its rights of action on executed contracts, such as those evidenced by bank notes or bonds, or on claims in debt, devolve upon the Crown, subject to payment of the corporation's own debts. It would, however, I think, in the present state of the authorities, be judicial legislation to declare the Crown entitled to maintain actions in such cases except where it can allege a trust. Such a declaration may have to be made, or advisedly refused, in the case of some of the rapidly-increasing number of companies which are being dissolved under the Companies Acts.

But in the present case it is not necessary to decide this question. Even if it be the law that a debt due to a corporation aggregate is extinguished by the dissolution of the corporation, I do not think that it follows that the Crown's claim fails in this case. The original assignees in the bankruptcy, and their successors in office, have from the time of the bankruptcy, been entitled to the old railway shares in trust for such creditors as had been or might be admitted to proof. The bank immediately before its dissolution was not a mere creditor. It was a creditor whose claim was in proof. Its claim was no longer a mere right of action for a debt. It could no longer have maintained an action as for a debt. The debt had been, at any rate provisionally merged in an equitable execution (*Twiss v. Massey* [1737] 1 Atk. 67, per Lord Hardwicke; *Cooke's Bankrupt Laws* [4th Ed.] c. 1, p. 5); and the right to sue had been replaced, not, indeed, by any particular interest in any specific chattels, but by a right to have all the assets, as and when realized, applied pro rata for the bank's benefit with the other creditors. This right as it seems to me, existed as an equitable interest or chattel at the time of the dissolution, and upon the dissolution of the bank that chattel or interest was not annihilated, but continued to be existing personal property, which devolved upon the Crown as bona vacantia as completely as any other equitable interest.

Alternatively, the case may be stated in a different way, but with the same result. From the time of the bankruptcy a title to the shares has been vested in the bankrupts' assignees and their successors in trust down to 1887 for the bank and the other creditors. In 1887 the bank disappeared. The assignees thereupon did not cease to hold the



title to the shares nor did they cease to hold it as trustees. Their title did not depend upon the continued existence of any particular debt or of any particular creditors, nor did it become extinct upon the extinction of particular creditors. It continued to be a title upon trust, and the Crown takes the place of the extinct cestui que trust. Suppose all the creditors had been corporations aggregate, and all had become dissolved, it seems clear that the assignees could not have taken the property as their own as against the Crown.

It does not seem necessary to examine minutely the provisions of the Bankruptcy Acts, in order to determine whether the money can be regarded as unclaimed dividends belonging to the statutory fund. If the proof is to stand good for the Crown's benefit, that is another way of saying that the moneys are not unclaimed dividends. If, on the other hand, the proof ought to be expunged, on the ground that the creditor and the creditor's claim are absolutely extinguished, then the case must be the same as if the proof had never been admitted, and the money ought to be divided amongst the other creditors. Unclaimed dividend seems to me to mean dividend which has been declared upon admitted and existing proofs, but which the persons entitled to it neglect to claim; it supposes the existence of some one who could claim and who omits to claim. Here the dividend belongs either to the Crown or to the other creditors, and it is claimed and therefore it is not unclaimed dividend.

For these reasons we think that the appeal must be allowed. \* \* \*

## MEMBERSHIP IN CORPORATIONS

I. Nature of Shares of Stock<sup>1</sup>

## JOHNS v. JOHNS.

(Supreme Court of Ohio, 1853. 1 Ohio St. 350.)

This is a petition, in which the plaintiff, the widow of Benjamin Johns, deceased, claims dower in forty-six shares of the capital stock of "The Mansfield & Sandusky City Railroad Company," and in ten shares of the capital stock of "The Ohio and Pennsylvania Railroad Company," of which shares her deceased husband, the said Benjamin Johns, was the owner at the time of his death.

The defendant Sherman, as executor as aforesaid, answers, admitting the facts alleged in the petition, but insisting that said shares are personal and not real estate.

THURMAN, J.<sup>2</sup> The Ohio and Pennsylvania Railroad Company was incorporated February 24, 1848. 46 Ohio L. L. 261. The 5th section of its charter provides that the company shall have all the powers and privileges, and be subject to all the restrictions and provisions of the "act regulating railroad companies," passed February 11, 1848. 46 Ohio L. 40. The third section of this latter act declares that the shares of stock in the companies that may be subject to its provisions, "shall be regarded as personal property, and shall be subject to execution at law." It is therefore manifest that the petitioner is not entitled to dower in the ten shares of the stock of The Ohio and Pennsylvania Railroad Company, for they are clearly personalty. But the question in respect to the stock in The Mansfield and Sandusky City Railroad Company is not so easily disposed of. For that company is not, so far as the case shows, subject to the provisions of said act of February 11, 1848. It was previously chartered and organized, and that act does not interfere with companies created before its passage. Turning then to the charter of the company, we find in it no provision declaring whether its stock is realty or personalty. We are thus brought to the general question, whether railroad shares in Ohio are, in the absence of express legislative enactment, to be considered as real or personal estate. This question must be determined by a reference to the principles of the common law and the general statutes of the state that have a bearing upon it. And its solution is not without difficulty; for, as to the common law, the adjudicated cases are directly conflict-

<sup>1</sup> For discussion of principles, see Clark on Corp. (3d Ed.) §§ 89, 90.

<sup>2</sup> A portion of the opinion is omitted.

ing, and when we resort to our statutes the chief aid we derive is from analogies and inferences. \* \* \*

In *Price v. Price's Heirs*, 6 Dana (Ky.) 107, the court of appeals of Kentucky, in 1838, held that the stock in the Lexington and Ohio Railroad Company is real estate. Without citing any adjudicated case, the court came to a conclusion which is thus expressed: "The right conferred on each shareholder is unquestionably an incorporeal hereditament. It is a right of perpetual duration, and though it springs out of the use of personalty, as well as lands and houses, this matters not. It is a franchise which has ever been classed in that class of real estate denominated an incorporeal hereditament."

On the other hand, the Supreme Court of Massachusetts, in 1798, in *Russell et al. v. Temple et al.*, 3 Dane Abr. (Mass.) 108, held that shares in incorporated bridge and canal companies are personalty. The case was between the widow and heirs of Thomas Russell, the former contending that the shares were personal property, and that consequently she was entitled to a distributive portion of them, and the latter insisting that they were realty, and that, therefore, she had but a dower estate. The question was very fully discussed, and was decided (says Professor Greenleaf in his edition of Cruise), "upon great consideration."

"For the heirs it was urged that these shares were real estate; because, it was said, the estates were real in the corporations; and that if the estates in the corporations were real, the estates of the individual members in them followed their nature, and were real; and that the frequent declarations of the legislature declaring such shares personal estate, at least show a doubt that when one has a right to receive rent, he has only a right to receive a sum of money, yet it does not follow that his estate is not real estate out of which his rent issues."

For the widow it was argued that the shares were personalty, because the estate (in the bridges, canals, towing-paths, wharves and lands), "can only exist in the corporation which alone can acquire it, alone be seized or possessed of it, alone pass it away, manage, or repair it, and so must hold it entire; and that the corporation is a moral person to all the purposes of property. Its tenure is to their successors, or to their successors and assigns. The estates can never vest in or be divided among the individual members, to hold as tenants in common, etc., in their private capacities. Only the corporation can possess the estate, and that only by possessing the charter; and only the corporation can be taxed for it on common-law principles; and on these can it alone be taken in execution for the debts of the corporation."

"That the share is personal estate though the corporation hold real estate; for the individual member has no estate, but only a right to such dividends as the corporation from time to time assigns to him. He is unknown in the grants made to it, and he cannot grant any part of the estate: nor can he be taxed for it but by statute law; nor can



any private member of a corporation be distrained for a public concern of it; his only remedy for his dividend is case in assumpsit, or an action on the case for a wrongful refusal or neglect to pay or allow him his part of the profits."

The judgment of the court was, as I have stated, that the shares were personal estate. "The principal reason of the decision," says Dana, "appears to be, because the court considered that the individual member or shareholder had only a right of action for a sum of money, his part of the net profits or dividends. And so the law has been held to be since this decision was made." \* \* \*

A careful examination of the adjudications upon the subject has brought us to the conclusion that, according to the weight of authority, the shares in question are personal property. In the early English cases the distinction, now well understood, between the property of a corporation and the rights of its members, does not seem to have been taken, and it appears to have been assumed that each shareholder had an estate in the corporate property, and that, consequently, if that property was real, his share was also realty. But the cases we have cited abundantly show that the distinction above mentioned is now fully recognized in England, and that the property of a corporation may be mainly, if not wholly real, and yet the shares of its members be personalty. \* \* \*

In whatever way we view the case, whether upon adjudication, reason, or our statute laws, we arrive at the conclusion that the shares in question are personal property. The bill must, therefore, be dismissed.

Bill dismissed.

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### MEEHAN v. SHARP.

(Supreme Judicial Court of Massachusetts, 1890. 151 Mass. 564, 24 N. E. 907.)

Exceptions from superior court, Suffolk county; James M. Barker, Judge.

Action of contract to recover for the sale and delivery of plaintiff's right, title, and interest in and to 50 shares of stock in a corporation. The defendant asked the court to rule that the delivery and acceptance of the indorsed certificate was not a sufficient acceptance and receipt to take the case out of the statute of frauds, and that the agreement was void. The court declined so to rule, and instructed the jury that if the defendant verbally agreed with the plaintiff to buy of him the 50 shares mentioned in the certificate, and to pay him therefor \$5 a share, and thereupon, in pursuance of that agreement, the plaintiff delivered to the defendant, and the defendant received and accepted, the indorsed certificate, the plaintiff could recover.

KNOWLTON, J. The plaintiff had a certificate showing that he was the beneficial owner of 50 shares of stock in a corporation. The shares

had not been issued, but were held in pool, and were to be issued whenever the board of directors should vote to authorize a delivery of them, and, if they should not so vote within six months from the date of the certificate, were to be delivered to the plaintiff forthwith on demand, and the presentation of the certificate. Under the instructions of the presiding justice, the jury must have found that the defendant verbally agreed with the plaintiff to buy of him the 50 shares mentioned in the certificate, and to pay him therefor \$5 a share; and that thereupon, in pursuance of the agreement, the plaintiff delivered, and the defendant received and accepted, the certificate, with the plaintiff's indorsement of his name on the back thereof.

It has been held in this commonwealth and in several other states that shares of stock in a corporation are within the provisions of the statute of frauds in regard to sales of "goods, wares, or merchandise for the price of fifty dollars or more." Pub. St. c. 78, § 5; *Tisdale v. Harris*, 20 Pick. 9; *Boardman v. Cutter*, 128 Mass. 388; *Pray v. Mitchell*, 60 Me. 433. In England, although the law was formerly otherwise, and in some of the American states, such shares are not held to be "goods, wares, or merchandise," but a different and peculiar kind of property, to which the statute does not apply. *Duncuft v. Albrecht*, 12 Sim. 189; *Humble v. Mitchell*, 11 Adol. & E. 205. In *Somerby v. Buntin*, 118 Mass. 279, 19 Am. Rep. 459, it was decided that an oral agreement for the sale of an interest in an invention before letters patent are obtained may be enforced; and it was said in the opinion that "the words of the statute have never yet been extended by any court beyond securities which are subjects of common sale and barter, and which have a visible and palpable form."

In the present case it is at least doubtful whether the contract, which was for the sale of stock that had not been regularly issued, can properly be brought within the statute, under the authorities in this commonwealth. If not, the instruction was sufficiently favorable to the defendant. But if we assume, in accordance with the defendant's contention, that the plaintiff's interest in the stock was "goods, wares, or merchandise," the only question in this case is whether the defendant's receipt and acceptance of the indorsed certificate was sufficient to charge him with a liability for the price. The plaintiff's indorsement, in connection with the sale of his interest in the stock and the delivery of the certificate, impliedly authorized the defendant to write over the signature a contract of assignment of the plaintiff's rights in the property. In view of the nature of the interest sold, the delivery was the only one possible. The defendant received and accepted all that was capable of manual transfer. His receipt and acceptance, under the circumstances, must be deemed to have been for the purpose of assuming control of the property. He had all the indicia of ownership, he acquired all the possession which it was possible to take of the property, and his act was constructive acceptance of the property itself. In this aspect of the case the instruction was correct. *Badlam v. Tucker*,

1 Pick. 389, 11 Am. Dec. 202; Pratt v. Parkman, 24 Pick. 42; Audenreid v. Randall, 3 Cliff. 99, 113, Fed. Cas. No. 644; Dows v. Greene, 24 N. Y. 638.

Exceptions overruled.

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## II. Certificates of Stock<sup>3</sup>

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### UNITED STATES RADIATOR CORPORATION v. STATE.

(Court of Appeals of New York, 1913. 208 N. Y. 144, 101 N. E. 783, 46 L. R. A. [N. S.] 585.)

Appeal from Supreme Court, Appellate Division, Third Department.

Claim by the United States Radiator Company against the State of New York for refund of taxes paid under protest on stock transfers. From a judgment of the Appellate Division (151 App. Div. 367, 135 N. Y. Supp. 981), affirming a judgment of the Court of Claims dismissing the claim, claimant appeals. Affirmed.

COLLIN, J. The action is to recover from the state of New York a sum paid by the plaintiff, under protest and without prejudice to its rights, for stock transfer stamps.

The facts were agreed upon by the parties for submission to the Court of Claims. The plaintiff, a corporation, purchased certain assets of each of four corporations. Under the contracts of purchase, each of the four corporations was entitled to a designated number of shares of the capital stock of the plaintiff as a consideration for the sale. Each of the four corporations and a trust company entered into a lawful voting trust agreement, which provided that the trust company as voting trustee should hold and vote for a designated period the full number of the shares of stock to which the four corporations were so entitled and a certificate for those shares was issued by the plaintiff, upon the request of each of the four corporations, to the trust company, which thus became the record owner of the shares for voting purposes. Each of the four corporations (no condition forbidding) requested the issue to each stockholder therein by the trust company of a certificate for the number of shares proportionate to the number of the shares of its stock owned by him, and thereupon the trust company issued to each stockholder of the four corporations a certificate that he, the stockholder, was the owner of a designated number of shares of the capital stock of the plaintiff deposited with and to be held by the trust company under the agreement as voting trustee, and might transfer the certificate, and that all dividends received by the trust company should be paid to the holder of the cer-

<sup>3</sup> For discussion of principles, see Clark on Corp. (3d Ed.) § 91.



tificate who should at the termination of the voting trust agreement, upon surrender of the certificate, be entitled to receive a certificate or certificates of the plaintiff for said shares of capital stock. Pursuant to the decision of the Comptroller of the State that the certificates of the trust company were taxable under section 270 of the Tax Law (Consol. Laws 1909, c. 60), the plaintiff paid for the transfer stamps without prejudice to its rights, and brings this action to recover the sum paid.

The statutory provisions authorizing and regulating the procedure in the action are: Section 276 of the Tax Law empowers the State Comptroller to ascertain whether any stock transfer tax imposed is unpaid and, if unpaid, to enforce the recovery of it and any penalty incurred by the nonpayment. Section 280 (added by chapter 186, Laws 1910) empowers him to pay to a person the amount erroneously paid as the tax, and authorizes the taxpayer to file with the Court of Claims a claim rejected by the comptroller, "which shall constitute a private claim against the state and shall be subject to all the provisions of law governing such claims, except" the provisions relating to the time within which it shall be filed. The action was commenced "under the provisions of law governing such claims" which are familiar and do not require a particular reference. Section 62 of the Executive Law (Consol. Laws 1909, c. 18) authorizes the Attorney General, on behalf of the state, to "agree upon a case containing a statement of the facts and submit a controversy for decision to a court of record which would have jurisdiction of an action brought on the same case, pursuant to the provisions of" sections 1279, 1280, 1281 of the Code of Civil Procedure, authorizing the submission to a court of record of a controversy upon facts submitted. The Court of Claims was a court of record. Judiciary Law (Consol. Laws 1909, c. 30) § 2.

At the time of the transactions under consideration, section 270 of the Tax Law (Consol. Laws 1909, c. 60) contained the following provisions: "There is hereby imposed and there shall immediately accrue and be collected a tax, as herein provided, on all sales, or agreements to sell, or memoranda of sales, or deliveries, or transfers, of shares or certificates of stock, in any domestic or foreign association, company or corporation, \* \* \* whether made upon or shown by the books of the association, company or corporation, or by any assignment in blank, or by any delivery, or by any paper or agreement or memorandum or other evidence of transfer or sale whether entitling the holder in any manner to the benefit of such stock, or to secure the future payment of money or the future transfer of any stock, on each share of one hundred dollars of face value or fraction thereof, two cents. \* \* \* The payment of such tax shall be denoted by an adhesive stamp or stamps affixed as follows: In a case where the evidence of transfer is shown only by the books of the company the stamp shall be placed upon such books; and where the change of

ownership is by transfer of a certificate the stamp shall be placed upon the certificate; and in cases of an agreement to sell or where the transfer is by delivery of the certificate assigned in blank there shall be made and delivered by the seller to the buyer a bill or memorandum of such sale to which the stamp provided for by this article shall be affixed; and every bill or memorandum of sale or agreement to sell before mentioned shall show the date thereof, the name of the seller, the amount of the sale, and the matter or thing to which it refers, and no further tax is hereby imposed upon the delivery of the certificate of stock, or upon the actual issue of a new certificate when the original certificate of stock is accompanied by the duly stamped memorandum of sale."

The section imposes the tax upon all agreements or instruments for the transfer of shares of corporate stock. It is in the nature of an excise tax on the transfer. *People ex rel. Hatch v. Reardon*, 184 N. Y. 431, 77 N. E. 970, 8 L. R. A. (N. S.) 314, 112 Am. St. Rep. 628, 6 Ann. Cas. 515. The language expresses clearly the intention of the Legislature that every transfer of or agreement to transfer a share in the capital stock of a corporation, or in other and definitive words, a right to share in the dividends declared by the directors of a corporation from its surplus profits and in the assets upon the distribution of them pro rata among the shareholders at its dissolution shall be subject to the tax.

A share of corporate stock is the right which the shareholder has to participate according to the number of shares in the surplus profits of the corporation on a division, and in the assets or capital stock remaining after payment of its debts on its dissolution or the termination of its active existence and operation. *Plimpton v. Bigelow*, 93 N. Y. 592; *Jermain v. Lake Shore & Mich. So. Ry. Co.*, 91 N. Y. 483. It is created by the joint action of the corporation and the shareholder. It imports a contribution to the capital stock made by the shareholder and accepted by the corporation. When a corporation has agreed that a person shall be entitled to a certain number of shares for a consideration permitted by law and executed by the person, those shares come into existence and are owned by him.

The statement in the certificate of incorporation or charter of the corporation that the capital stock is a designated amount divided into a certain number of shares, each of a named value, creates neither shares nor capital stock. It expresses the power of the corporation to acquire a capital stock. It creates potential shares which, transferred into actual shares by the acquisition of members and their payments, produce the money or property which, put into a single corporate fund, is the actual capital or capital stock on which the corporate business is undertaken and in which are the shares. It also fixes the sum of the payment necessary to create a share.

The certificate of the corporation for the shares, or the stock certificate, is not necessary to the existence of the shares or their ownership.

It is merely the written evidence of those facts. It expresses the contract between the shareholder and the corporation and his co-shareholders. But it is the payment, or the obligation to pay for shares of stock, accepted by the corporation, that creates both the shares and their ownership. *Burrall v. Bushwick R. R. Co.*, 75 N. Y. 211; *Christensen v. Eno*, 106 N. Y. 97, 12 N. E. 648, 60 Am. Rep. 429; *Southworth v. Morgan*, 205 N. Y. 293, 98 N. E. 490; *Buffalo & N. Y. City R. R. Co. v. Dudley*, 14 N. Y. 336; *Dayton v. Borst*, 31 N. Y. 435; *Flour City National Bank v. Shire*, 88 App. Div. 401, 84 N. Y. Supp. 810, affirmed 179 N. Y. 587, 72 N. E. 1141. In the last case cited, Judge Hiscock, then Justice Hiscock, writing for the court, said: "The company having thus acquired property under an agreement to give therefor to various people certain interests or shares in its capital stock, we think that such latter persons, immediately upon the acceptance of transfers by the corporation, became entitled to and vested with said interests or shares, and that no further steps were necessary to accomplish this latter result. It may be admitted at once that ordinarily the corporation would issue certificates for these shares of capital stock, but it is too well settled to permit of doubt that said certificates would be merely representative of and not the real interest in the property and assets of the corporation constituting its actual capital stock." 88 App. Div. at page 405, 84 N. Y. Supp. at page 813.

Each of the four corporations became, upon the transfer of its assets to the plaintiff, the owner of the shares of the capital stock of the plaintiff, which were the consideration for it. The transaction did not involve a transfer of those shares. The shares were not transferred to the vendor corporation by plaintiff; they were created by the transaction. At no time were they owned by the plaintiff. At the instant of their creation they were owned by the vendor corporation, which might at any time thereafter transfer them, and any transfer of them by it would be subject to the tax imposed by said section 270.

The four corporations did not transfer the shares owned by them to the trust company. They caused the record title to them to be placed in the trust company temporarily and for an expressed and limited purpose. They remained the owners of the stock. Their ownership was subject to the right of the trust company to vote the shares at corporate elections, but the power to transfer the shares, subject to the right of the trust company to vote them, remained in the corporations. The trust company could not sell or agree to sell the shares. It had no assignable interest in them. It had evidence in the certificate that it as trustee held the legal title, but this was notice of the existence of the trust agreement which disclosed the ownership of the corporations.

The valid request of each of the four corporations to the trust company that it issue its certificate to each of the holders of shares of the stock of those corporations for shares of the stock of the plaintiff proportionate to his holding, and the compliance of the trust com-



pany, was a transfer of the shares by the corporations to their shareholders. Upon the completion of those acts the corporations ceased having the right to receive the dividends declared upon those shares and the shareholders acquired it. The ownership of the shares is in their stockholders severally, as certified by the trust company, by virtue of the assignment of it inherent in the request and the execution of the request by the trust company. The appellant does not assert or claim that the corporations own the shares. It, on the contrary concedes that their shareholders are the owners, but asserts that they were such through and from the time of the purchase by the plaintiff of the assets of the corporations, and therefore there was no transfer of the shares from the corporations to them—an assertion erroneous, as already stated.

The appellant urges, with ability and earnestness, that if the four corporations did in the first instance own the shares, the transfer of them to the shareholders was a division among the true owners of their own property, and therefore not a taxable transfer. Without deciding whether or not the conclusion correctly expresses the law, it suffices in this case to point out that the premise given for its support is fallacious. While conditions may exist under which equity will consider the shareholders as the proprietors and the ultimate beneficiaries of the corporate interests, the fact is that a corporation is an individual being incapacitated through statutory powers to acquire the title to, own, and dispose of real and personal property, enter into contracts, engage in business, sue and be sued and taxed. It is the owner of all the corporate property, real and personal, and within the powers conferred upon it by the charter can deal with it as absolutely as a private individual can with his own. The whole title to it is in the corporation, and the shareholders are neither tenants in common nor in any legal sense the owners of it. *Hyatt v. Allen*, 56 N. Y. 553, 15 Am. Rep. 449; *Gibbons v. Mahon*, 136 U. S. 549, 10 Sup. Ct. 1057, 34 L. Ed. 525; *Lowry v. Farmers' Loan & Trust Co.*, 172 N. Y. 137, 64 N. E. 796; *Humphreys v. McKissock*, 140 U. S. 304, 11 Sup. Ct. 779, 35 L. Ed. 473; *Buffalo L. T. & S. D. Co. v. Medina Gas & El. L. Co.*, 162 N. Y. 67, 56 N. E. 505. A shareholder cannot acquire title to any of the property of the corporation through the operation of the law as an administrator acquires the title to the personal property of his intestate. A corporate act alone can effect that result. When the act, as did the act in the present case, transfers to the shareholders shares of the capital stock of another corporation, it is taxable under said section 270.

The judgment should be affirmed, without costs.

CULLEN, C. J., and WERNER, CUDDEBACK, and MILLER, JJ., concur. GRAY and HISCOCK, JJ., dissent.

Judgment affirmed.

### III. Subscriptions to Stock after Incorporation <sup>4</sup>

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#### GALBRAITH v. McDONALD.

(Supreme Court of Minnesota, 1913. 123 Minn. 208, 143 N. W. 353, L. R. A. 1915A, 464, Ann. Cas. 1915A, 420.)

Appeal from District Court, Washington County; P. H. Stolberg, Judge.

Action by J. P. Galbraith, as trustee, against P. F. McDonald. Judgment for plaintiff, and defendant appeals. Affirmed.

HOLT, J. The only question presented by the appeal is the right to recover upon a promissory note given to a corporation for a share of its stock, when the only defense is a failure to deliver or tender a share certificate. The record discloses that the first meeting of the stockholders of the Washington County Co-operative Company, a corporation, was held in March, 1909. The corporation was organized to carry on a mercantile business at Stillwater. To promote the business the plan was to obtain patrons for the store by inducing farmers and others who lived within trading distance to become shareholders in the corporation. The defendant alleges that he was solicited to subscribe by a duly authorized representative of the corporation, and pursuant to such solicitation, he on June 24, 1909, bought one share and gave in payment the note in suit. The note was subsequently pledged, but is now in the hands of the plaintiff as trustee in bankruptcy of the corporation. The defendant alleged that the note was executed upon the agreement that a share certificate should be delivered concurrently with delivery of the note, but no attempt was made to prove such a contract. The court found, upon the uncontradicted testimony of defendant, that he bought one share of stock in the corporation, for which he gave the note in suit for \$100, payable to the order of the corporation within one year from date, and at the same time he received a receipt so stating. It was also found that no certificate for the share so bought was issued by the corporation to defendant. Judgment was ordered for plaintiff. Defendant appeals.

Plaintiff contends that the transaction between defendant and the corporation amounted to a subscription to a share of stock, and defendant that it was a contract of sale. There is no statute prescribing the mode in which a person may become a shareholder in a corporation. Previous to organization, it is necessarily through subscription to shares of stock to be issued; after incorporation, it may also be by subscription, or by purchase from the corporation direct, or from other owners of its stock. It might well be claimed that the

<sup>4</sup> For discussion of principles, see Clark on Corp. (3d Ed.) § 92.

transaction here under consideration was a subscription. Defendant alleged that his subscription was solicited. He gave the note and obtained the receipt, showing him entitled to one share. A promissory note embodying a statement that stock of a corporation is to be issued to the maker has been held to be a subscription contract. *President, etc., of the Goshen & Minisink Turnpike Road v. Hurtin*, 9 Johns. (N. Y.) 217, 6 Am. Dec. 273; *Wemple et al. v. St. Louis, J. & S. Railroad Company*, 120 Ill. 196, 11 N. E. 906. In the latter case it is said: "The rule is, where no formalities are prescribed, any agreement by which a person shows an intention to become a shareholder upon the terms set forth in the company's charter is sufficient to constitute a contract of subscription." If a subscription, then it is settled by *Columbia Electric Co. v. Dixon*, 46 Minn. 463, 49 N. W. 244, and *Marson v. Deither*, 49 Minn. 423, 52 N. W. 38, that the fact that a certificate has not been delivered or tendered is no defense to a suit on the subscription.

But, even if defendant was not a subscriber to the share of stock, we think his testimony and the findings make it clear that as between him and the corporation he became a shareholder therein by the transaction. Defendant claims he bought one share of stock, for which the corporation accepted his note in payment. It was not necessary that a certificate be issued. That is a mere indicia of title to the share. *Randall Printing Co. v. Sanitas Mineral Water Co.*, 120 Minn. 268, 139 N. W. 606, 43 L. R. A. (N. S.) 706; *Marson v. Deither*, *supra*. The defendant did not insist upon a certificate at the time of the transaction; nothing was said as to when it should issue. Having thus left this matter in abeyance, he must at least make a demand for it before he can place the other party in default, or else he must show that a demand would have availed nothing. Plaintiff is not suing upon a contract of sale and purchase. If defendant, instead of giving his note, had paid cash and obtained the receipt he did obtain, could he possibly have any standing in court to recover back the money so paid by simply proving that he had paid it for a share of the stock, but no certificate had ever been delivered or tendered to him? We think not. He would at least be under the necessity of proving a demand. He neither pleads nor proves any demand, nor any excuse for failing so to do in this case. Text-books and decisions assert that there is distinction to be noted between sales of corporate stock and subscriptions thereto. That is undoubtedly true in respect to executory contracts of sale. But where an actual sale has been made, and the title to the stock has passed, we fail to see any distinction between persons who are subscribers to stock and those who have actually bought it of the corporation. Both at some time become entitled to a certificate upon demand, both are entitled to dividends, and both must bear risks as shareholders. Cases like *Clark v. Continental Imp. Co.*, 57 Ind. 135, *Nicholls v. Reid*, 109 Cal. 630, 42 Pac. 298, *Bartlett v. Scott*, 55 Neb. 477, 75 N. W. 1102, and others which might be cited,



are not applicable, because according to the terms of the contracts involved payment was to be made upon delivery of the certificates. *Craig Silver Co. v. Smith*, 163 Mass. 262, 39 N. E. 1116, turned on the point that the certificates tendered were not the ones called for by the contract.

It has been suggested that there is a failure of consideration, because it appears that the corporation is now bankrupt. Of course, if the rights of a shareholder passed to defendant by his purchase, there was a consideration at the time. The mere fact that the value of this right may since have dwindled away does not constitute a defense to the note. The cases of *Clark v. Turner*, 73 Ga. 1, and *Leigh v. Chattanooga Ry. Co.*, 104 Ga. 13, 30 S. E. 381, are not applicable, for it there appeared that no certificate could be issued, because no more stock remained. There is no evidence to support the allegations in the answer that the certificate cannot now be delivered, or that the share has now no value.

Order affirmed.

BROWN, C. J. I am unable to concur in the decision rendered in this case. There are two possible theories upon which plaintiff might prevail, neither of which in my opinion is tenable under the facts presented in the record: (1) Upon the theory that the promissory note is an enforceable obligation, notwithstanding the fact that the consideration therefor, the stock of the corporation, has never been issued or tendered to defendant, and cannot now be issued, the corporation being in the hands of a trustee in bankruptcy; and (2) under the doctrine of estoppel in the interests of creditors. It seems clear to me that plaintiff cannot, on the record before us, prevail upon either ground.

1. The note was given for a certificate of stock in the corporation. No certificate of stock was ever issued or tendered to defendant, and the record is wholly silent upon the question when it was to be issued. Defendant testified that he agreed with an agent of the corporation to purchase the stock if the company would give him a year in which to make payment. The agent granted the time, and the execution of the note followed. Nothing being said or agreed upon as to when the stock should be issued, the presumption necessarily arises that it was to be issued when the note became due and was paid. In this situation the payment and issue of the stock were dependent and concurrent acts. Defendant could not insist upon a delivery of the stock without payment of the note, nor could the corporation insist upon payment without issuing and tendering the stock. *Railway Co. v. Robbins*, 23 Minn. 439; *Wood Harvester Co. v. Jefferson*, 57 Minn. 456, 59 N. W. 532. The case comes within the general rule that in all contracts to be performed in the future, in which the acts of the parties in performance are dependent and concurrent, neither can seek affirmative relief without first tendering performance on his part. 38 Cyc. 132, and authorities there cited. That this contract was execu-

tory, and to be completed when the note was paid and stock issued, seems quite clear. The corporation, through the trustee, is seeking affirmative relief without tendering performance, and this, under the rule stated, cannot be done. The plaintiff, trustee in bankruptcy, is in no better position than the corporation would have been, had it brought the action. Defendant asks no affirmative relief; he pleads defensive matters only. It was not incumbent upon him to demand the stock in order to render his defense available. Affirmative action looking to the completion of the contract rested upon the corporation, for it could not insist upon payment without tendering the stock. Plaintiff must therefore fail on this theory of the case. The Robbins and Jefferson Cases above cited are in harmony with the rule laid down by text-writers and almost universally followed by the courts. 3 Notes to Minn. Cases, 1164; note by Judge Freeman in 93 Am. St. Rep. 352, 386.

2. Nor can recovery be had upon the doctrine of estoppel. The action is brought by the trustee in bankruptcy of the defunct corporation, and in the interests of creditors of the concern. The record presents no case of estoppel. It is wholly silent upon the question whether the defendant was ever recorded in the books of the corporation as a stockholder or a subscriber for stock. Nor does it appear that defendant ever in any way participated in the affairs of the company, or that the creditors dealt with the company in reliance upon his supposed connection therewith. Defendant, by the transaction of purchase, did not at that time become a stockholder as a matter of law. The contract being executory, no rights or liabilities arose until the note was paid or the stock issued. *Railway Co. v. Robbins and Harvester Works v. Jefferson*, *supra*. The corporation was a going concern at the time of the transaction, and the rules of law applicable to subscription contracts, made to aid in the formation of the corporation, do not apply. 93 Am. St. Rep. 352, 386.

#### IV. Subscriptions to Stock Prior to Incorporation <sup>5</sup>

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##### WRIGHT BROS. v. MERCHANTS' & PLANTERS' PACKET CO.

(Supreme Court of Mississippi, 1913. 104 Miss. 507, 61 South. 550,  
Ann. Cas. 1915C, 1111.)

Appeal from Circuit Court, Warren County; H. C. Mounger, Judge.

Action by the Merchants' & Planters' Packet Company against Wright Bros. Judgment for plaintiff, and defendants appeal. Reversed and remanded.

Certain business men of the city of Vicksburg undertook the organization of a packet company for the purpose of plying a steamboat on the Yazoo river, in order to secure better service and rates. The promotion of the undertaking was in the hands of C. J. Searles and others, who secured subscription to the capital stock of the company. Searles approached C. G. Wright, of the firm of Wright Bros., hardware merchants, and asked for a subscription, and was told by Wright that they would help, and would let him know later about the amount. Searles entered the name of Wright Bros. on the subscription list, but left the amount blank. Afterward, at a meeting of the promoters, when some proposition was to be voted upon, C. G. Wright voted \$500 of stock in the name of Wright Bros. This was before the organization of the corporation, and Wright claims that before organization he advised Searles that he would withdraw his subscription. The corporation was subsequently organized and met with financial reverses, and suit was brought against the firm of Wright Bros. for the unpaid subscription appearing on the subscription list, and a judgment secured for the full amount.

On appeal the defendants assign as error, among others, the refusal of the eleventh instruction asked by them, and the granting of instruction No. 2 asked by appellee, which are as follows:

"No. 11. The jury are instructed that, unless the evidence in this case shows to their satisfaction that the plaintiff was organized under a legal charter, they must find for the defendant; and if there is no evidence of such organization, then the jury should find for the defendant."

"No. 2. The court instructs the jury that if they believe from the evidence that the defendants attended the meeting of the stockholders, represented by Mr. C. G. Wright, and that if the jury further be-

<sup>5</sup> For discussion of principles, see Clark on Corp. (3d Ed.) §§ 93-97.



believes that the name of 'Wright Bros.' was called for a vote, and that Mr. C. G. Wright heard the name of 'Wright Bros.' called and voted ten shares of stock, without objecting or remonstrating, or without making it known to the other stockholders that he voted as an individual, and not for the firm of Wright Bros., then the jury will find for the plaintiff in the sum of \$500 and interest, even though the jury further believes from the evidence that Mr. C. G. Wright, or the firm of Wright Bros., had not previously authorized Capt. Searles to write Wright Bros.' name on the prospectus."

SMITH, C. J. Appellee instituted this suit in the court below to recover from appellants the sum of \$500, alleged to have been subscribed by them to its capital stock prior to its organization. In addition to the general issue, appellants filed several special pleas, one of which set up that they had withdrawn their subscription to the capital stock of appellee, and notified the promoters thereof, prior to appellee's organization as a corporation, to which plea a demurrer was interposed and sustained. This demurrer should have been overruled, for the reason that, in the absence of a special agreement to the contrary, supported by a valuable consideration, a subscription to the capital stock of a corporation, thereafter to be organized, is nothing more than an offer of a specific sum to the use of the corporation when it comes into existence, and therefore, under familiar principles of law, may be withdrawn at any time before the organization of the corporation. While there are authorities to the contrary, this view is in accord with the great weight thereof and of reason, as will appear from an examination of 1 Thompson on Corporations (2d Ed.) § 518; 1 Cook on Corporations, § 167; Planters' & Merchants' Independent Packet Co. v. Webb, 156 Ala. 551, 46 South. 977, 16 Ann. Cas. 529; Bryant's Pond, etc., v. Felt, 87 Me. 234, 32 Atl. 888, 33 L. R. A. 593, 47 Am. St. Rep. 323, and authorities cited in note thereto; Hudson Real Estate Co. v. Tower, 156 Mass. 82, 30 N. E. 465, 32 Am. St. Rep. 434; Wallace v. Townsend, 43 Ohio St. 537, 3 N. E. 601, 54 Am. Rep. 829.

While this question seems not to have been heretofore presented to this court for decision, the rule as herein announced was evidently understood to be the correct one by the judges who composed the High Court of Errors and Appeals when the case of Hayne v. Beauchamp, 5 Smedes & M. 515, was decided; for Judge Sharkey, in delivering the opinion therein, used the following language: "But it is insisted that a distinction is to be taken between those cases in which the subscription is made to an existing corporation, and a mere subscription in view of a subsequent charter. True, there is a distinction. In the latter case the subscription, or the undertaking is not always obligatory; in the first it is," etc. And Judge Clayton, in his dissenting opinion, said: "Before the bank went into operation, and incurred liabilities, he [referring to a subscriber to its capital stock] might have withdrawn:

to permit him to do so afterwards would, in my apprehension, violate some of the elementary principles of law and justice."

It may be that the eleventh instruction requested by appellant was properly refused by the court, for the reason that it submitted to the jury a question of law, instead of one of fact, as to which we express no opinion; but the principle announced therein is correct, for "it is well settled by the authorities that a subscription to the stock of a proposed corporation cannot be enforced unless a *de jure* corporation is completed, and this fact is shown by the evidence. It is a reasonable conclusion in cases of this character that the subscriber intended to become a stockholder in a legally organized corporation, or, in other words, a *de jure* corporation, and not in a corporation defectively organized and existing as a corporation by a species of *suffrage*." 1 Thompson on Corporations (2d Ed.) § 272.

Appellee's second instruction ought not to have been given, for the reason, among others, that it declared upon a written contract, and by this instruction was permitted to recover upon a contract which the court held would arise by implication, from the fact that one of the members of appellants' firm attended a preliminary meeting of appellee's prospective stockholders and voted therein.

It does not appear from the evidence that the ownership of stock in corporations, either in general, or in corporations of the character of the one here in question, was within the scope of appellants' business; nor does it appear that C. G. Wright was authorized by the other member of the firm to subscribe to appellee's capital stock, if he in fact did so subscribe. Consequently, he alone, in any event, can be held liable therefor.

Reversed and remanded.

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### THRASHER v. PIKE COUNTY R. CO.

(Supreme Court of Illinois, 1861. 25 Ill. 393.)

This was an action of *assumpsit*, by the Pike County Railroad Company against Charles Thrasher, upon an agreement to subscribe for stock in the plaintiff corporation. \* \* \* A jury was waived and a trial had by the court, who found the issues for the plaintiff, and, refusing a motion for a new trial, rendered judgment against the defendant for \$3,000 and costs. The opinion of the court states the other material facts of the case.

BREESE, J.<sup>6</sup> The appellee, who was plaintiff in the court below, urges several reasons justifying a recovery in this case, which it is necessary to notice. The declaration contains a special count, averring, that on the nineteenth of March, 1856, the plaintiffs were a body politic and corporate, with power to construct and operate a railroad

<sup>6</sup> The statement of facts is abridged and a portion of the opinion is omitted.

within the county of Pike, and authorized by law, as such corporation, to secure subscriptions to the capital stock of the company to the amount of one million of dollars, in shares of one hundred dollars each, and, desiring to ascertain what amount of stock would be subscribed, and not having opened regular subscription books, but intending so to do, agreed with the defendant that they would, in a reasonable time thereafter, open books for the purpose of securing such subscriptions, and that they would permit and allow the defendant, when the book should be opened, to subscribe to the capital stock of the company thirty shares of one hundred dollars each, and upon payment therefor, the defendant should be the owner of thirty shares of the capital stock of the company. It is then averred, that the defendant, in consideration of this promise, undertook and promised the plaintiff that he would subscribe to the stock of this company the sum of three thousand dollars, when the books should be opened for subscriptions; that this promise was by a writing, signed by the defendant, and by him delivered to the plaintiff. It is then averred, that on the same day, subscription books to the capital stock of the company were opened, of which the defendant had notice. The breach is, that the defendant neglected and refused to subscribe anything to the capital stock, accompanied by an averment that the subscription, when the books were opened, was due and payable before the commencement of the suit, and although notified thereof, the defendant has refused to pay any part of the sum of three thousand dollars. The common counts are added, in one of which the indebtedness is alleged to be for one hundred shares of the stock of the Pike County Railroad, before that time bargained and sold to the defendant.

This is the cause of action as set forth by the plaintiffs, and it is claimed by them, that they are entitled to recover as damages the par value of the stock, or the amount of calls made from time to time upon it, and which, at the commencement of the suit, amounted to fourteen installments, of five per cent each, making, in all, twenty-one hundred dollars.

This, we do not think, is a fair view of the defendant's liability upon his promise, if one was made to the plaintiffs. His undertaking is, to subscribe a certain amount of stock, when the subscription books should be opened. This promise does not make him a stockholder, and, as such, liable to calls. The company has parted with no stock to him, and can only claim as damages, the actual loss sustained by them by his failure, or refusal to subscribe, when he was notified the books were opened for such purpose. The company has the stock which the defendant promised to take, but did not take. His promise is like any other promise, or agreement to purchase any specific article of property. If the property contracted for be retained by the vendor, and there is no delivery to the purchaser, or offer to deliver, the damages must not be measured by the value of the property; for it



would not be just, in such cases, that the vendor should retain the property, and recover, also, the value of it from the promisor. Some damage might result from the loss of a bargain, and to such the vendor would be entitled, if the extent could be established. In many cases, they would be merely nominal. On an agreement for the sale and purchase of stocks, and a refusal by the purchaser to take the stocks, the measure of damages, ordinarily, might be the difference between the par value of the stocks and their market value, or between them and money. As well argued by the appellant, the defendant having violated his promise by failing to subscribe, he has acquired no right to stock; nor could a recovery in this action entitle him to become a stockholder. The company retains its stock, and the defendant his money. A stock certificate of three thousand dollars would represent a value to the company equivalent to so much money, and, in a statement of their liabilities, this would appear against the company as so much held by the stockholders, for which the company was responsible. If there is no actual subscription, the company does not incur this liability.

There being no special damages alleged, or proved, we do not think the plaintiffs could recover under this declaration, as they have done, the par value of the stock the defendant promised and agreed to take. A proper count might doubtless be so framed as to justify a full recovery, under sufficient proof. \* \* \* Judgment reversed.

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## V. Subscriptions Induced by Fraud <sup>†</sup>

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### MORRISEY v. WILLIAMS.

(Supreme Court of Appeals of West Virginia, 1914. 74 W. Va. 636,  
82 S. E. 509, L. R. A. 1915D, 792.)

Appeal from Circuit Court, Mercer County.

Bill by A. Morrisey and others against C. L. Williams, receiver, and by C. L. Williams, receiver, against the Fidelity Banking & Trust Company and others. The cases were consolidated, and from the decree, Morrisey and others appeal. Reversed, and decree rendered.

ROBINSON, J. The appeal brings up for review decrees in consolidated causes, styled as Morrisey et al. v. Williams, Receiver, and Williams, Receiver, v. Fidelity Banking & Trust Co. et al. In the first named cause Morrisey sought, on the ground of fraud, a rescission of a sale of bank stock, which sale was made to him by an officer of the bank on its behalf only a short time before the bank as insolvent went

<sup>†</sup> For discussion of principles, see Clark on Corp. (3d Ed.) § 101.

into the hands of a receiver. The decree therein denies him relief. The object of the other cause was to enforce for the benefit of the creditors of the bank the so-called double liability of the stockholders. In it the receiver has decree against Morrissey for an amount equal to that of the shares of stock held by him under the sale that he sought to have rescinded in the first named suit. Morrissey complains of the decrees against him. If the decree in the first named cause must be reversed, the decree in the other cause necessarily falls. Clearly if the sale of the stock is rescinded, liability as a holder of the stock can not be enforced against Morrissey.

While we have great respect for the judgment of the learned chancellor who decided the causes, we are of opinion that the sale of the stock to Morrissey was fraudulent in equity and that under the facts and circumstances appearing he may have the same rescinded. We are confirmed in this view by the same chancellor's finding and decree in a cause presenting the same issues upon virtually the same facts and calling for the application of the same law, as in the Morrissey Case. That cause is *Scott v. Williams, Receiver*, 74 W. Va. 635, 82 S. E. 511, also here on appeal, and to be decided herewith by separate memorandum. Scott's Case, demanding on the ground of fraud a rescission of a sale to him of stock in the insolvent bank, is the same as Morrissey's. It is no stronger. Indeed the one is nearly identical with the other so that no practical distinction can be made between them. Yet in the Scott Case, decided some months later than the other, the chancellor decreed a rescission. It therefore appears that upon maturer consideration the chancellor most commendably confessed his error in the former decree in the Morrissey Case. One of the noblest traits of a judge is willingness to change his views when convinced that they are wrong.

It will serve no practical purpose to narrate the evidence in relation to the sale of the stock to Morrissey. It suffices to say that the facts and circumstances point clearly to the conclusion that the bank officer, by representations which he knew or at least was chargeable with knowing were false, palmed off on Morrissey stock in the insolvent bank, held by it as collateral to a past due note, through leading him to believe it was new stock, and took in lieu of the same from Morrissey a good and valuable certificate of deposit in a foreign bank. In less than a month thereafter the bank was forced to close its doors. The certificate of deposit is still in the hands of the receiver. In equity and good conscience it must be returned to Morrissey.

It is submitted for the receiver that a subscription or purchase of stock in a corporation can not be rescinded even for fraud when no action in that behalf is taken until after a declared insolvency of the corporation by a receivership, the rights of creditors then having stepped in as entitled to superior consideration. In many cases this is true. It is not true in this case. The rule rests on the rights of creditors.

When the reason for the rule does not arise, the rule is of course not applicable.

From the record it does not appear that the rights of creditors intervened between the time Morrissey took over the stock and the time the receiver took charge, a period, as we have said, of less than a month. It does not appear that liabilities of the bank accrued within this period for which the stockholders would be liable. We can not see that the liabilities increased one cent, or that a single new creditor came in, while the stock was in Morrissey's hands under the fraudulent sale. Liabilities of the bank accruing prior to the purchase by Morrissey of the stock did not attach against him as a stockholder. Our law plainly says that the stockholders are only liable for the liabilities of the bank "accruing while they are such stockholders." Const. art. 11, sec. 6 (Code 1913, p. cxxi), Code 1913, ch. 47, sec. 78aIII (sec. 3034); *Dunn v. Bank*, 74 W. Va. 594, 82 S. E. 758, L. R. A. 1915B, 168, decided at this term. Stockholders in banks by the issuance of new stock to them, or by the transfer of the stock of others to them, do not assume the so-called double liability as to debts of the bank existing prior to the issuance or transfer of the stock. They are liable only for debts accruing subsequent to their acquirement of the stock. A transferer of bank stock remains liable for debts of the bank that accrued while he held the stock. This is the plain import of our law. Similar provisions in other states are so understood. *Laws of Illinois*, 1889, page 59; *Shuey v. Holmes*, 21 Wash. 223, 57 Pac. 818. Surely it would not be equity to allow the receiver to apply Morrissey's money to the payment of creditors of the bank to whom the law does not bind him. Plainly Morrissey's right to a rescission is superior to the rights of creditors to whom debts were due from the bank before he became a stockholder. They lent no credit on the strength of his having stock, either theoretically or actually. They are in no worse position than if he had never purchased the stock. A rescission can do them no harm.

While the general principle relied on by the receiver is usually applicable when a considerable length of time elapsed between the purchase of the stock and the demand for rescission, yet sound authorities refuse to apply it under such circumstances as are disclosed in *Morrissey's Case*. We shall not cite the cases. The books readily disclose them. From a leading text the following is pertinent: "In England, and in some of the states in this country, it has been held that a subscription cannot be repudiated on the ground of fraud, for the first time, after the corporation has become insolvent, and has made an assignment or gone into the hands of a receiver or an assignee in bankruptcy, even though the fraud may not have been discovered before insolvency, and though there may have been no laches in discovering it. According to the better opinion, however, this doctrine cannot be sustained without qualification. Surely, the equity of a person who has been induced to subscribe for stock in a corporation, without negligence on his part, by the deceit of its officers or agents, and who has



not been guilty of negligence, either in failing to discover the fraud, or in repudiating his subscription after its discovery, cannot be said to be inferior to the equity of persons dealing with the corporation and becoming its creditors, and he should not be denied the right to set up the fraud as a defense in an action or other proceeding to enforce his subscription, merely because the corporation has become insolvent, and it is sought to enforce the subscription for the benefit of its creditors. The view that he has such right is supported by well-considered cases, both in England and in this country. This rule should undoubtedly be applied where no debts have been contracted by the corporation since the date of the subscription." 2 Clark and Marshall on Private Corporations, sec. 473g.

A complete examination of the authorities leads us to believe that the United States Circuit Court of Appeals of the Eighth Circuit, in *Newton National Bank v. Newbegin*, 74 Fed. 135, 20 C. C. A. 339, 33 L. R. A. 727, fairly states the law, wherein it is said: "If a considerable period of time has elapsed since the subscription was made; if the subscriber has actively participated in the management of the affairs of the corporation; if there has been any want of diligence on the part of the stockholder, either in discovering the alleged fraud, or in taking steps to rescind when the fraud was discovered; and, above all, if any considerable amount of corporate indebtedness has been created since the subscription was made, which is outstanding and unpaid,—in all of these cases the right to rescind should be denied, where the attempt is not made until the corporation becomes insolvent. But if none of these conditions exist, and the proof of the alleged fraud is clear, we think that a stockholder should be permitted to rescind his subscription as well after as before the company ceases to be a going concern."

Now, without entering into details, we may say that none of the conditions mentioned above as warranting a denial of rescission, appear in *Morrissey's Case*. No considerable period of time elapsed; Morrissey did not actively participate in the management of the affairs of the bank; there was no want of diligence on his part in discovering the fraud or in taking steps to rescind; and no considerable amount of the bank's indebtedness accrued while he held the stock. The mere presence of Morrissey at a meeting in response to a hurried call of the stockholders when the bank's failing condition first became generally known, can not bind him as participating in the management of the affairs of the bank. He would naturally go there to see how things stood. While there he in no way committed himself to keep the stock—in no way did that which would condone the fraud practiced on him. Indeed it is a reasonable inference that by the report of the president made at this meeting, Morrissey first realized that he had been deceived by the sale of the stock to him. Only a short time before that in the negotiation of the sale he had been assured by officers of the bank that its condition was flourishing. Nothing appears that would reasonably charge him with notice to the contrary. In two days after the meet-

ing the commissioner of banking closed the bank. Morrissey obtained leave to sue the receiver for rescission, at the earliest opportunity. He brought his suit at the first term of court available. What lack of diligence in taking steps to rescind? None. As to the last named condition—the accrual of indebtedness against the bank—we have already spoken. We have said that there is no proof of the accrual of indebtedness. If any did accrue, the inferences from the proof of what business the bank did during the time that Morrissey held the stock point to the fact that the same was inconsiderable.

What we have said sufficiently disposes of the questions determining the appeal. The decree in the first named cause will be reversed and a decree rescinding the sale of the bank stock will be here entered. The decree in the other cause will also be reversed in so far as it adjudges liability on the score of this particular stock.

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## VI. Right of Members to Inspect Books and Papers of Corporation<sup>8</sup>

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### POWELSON v. TENNESSEE EASTERN ELECTRIC CO.

(Supreme Judicial Court of Massachusetts, 1915. 220 Mass. 380, 107 N. E. 997.)

Report from Supreme Judicial Court, Suffolk County; John W. Hammond, Judge.

Petition in equity by W. V. N. Powelson, with an intervening petition by the Tennessee Mutual Development Company, against the Tennessee Eastern Electric Company and others, for inspection of books. Case reported by the single-justice for the full bench. Order for inspection to issue.

DE COURCY, J. This is a petition in equity under section 30 of the business corporation law (St. 1903, c. 437), seeking an inspection of the stock and transfer books of the defendant corporation. It is provided in that section that: "The stock and transfer books of every corporation, which shall contain a complete list of all stockholders, their residences and the amount of stock held by each, shall be kept at an office of the corporation in this commonwealth for the inspection of its stockholders."

Liability for damage caused by a refusal to exhibit the books, etc., is specified; and the section concludes as follows: "The Supreme Judicial Court or the superior court shall have jurisdiction in equity, upon petition of a stockholder, to order any or all of said copies, books or

<sup>8</sup> For discussion of principles, see Clark on Corp. (3d Ed.) § 134.

records to be exhibited to him and to such other stockholders as may become parties to said petition, at such a place and time as may be designated in the order."

The preliminary objection that Powelson, as one of the three voting trustees, cannot exercise the rights of a stockholder under the statute need not be considered. It is admitted that the intervening petitioner, the Tennessee Mutual Development Company, was the owner of ten shares of the common stock of the defendant corporation, that it duly made a demand to inspect the stock and transfer books of the electric company, and that the demand was refused. It has become a party to the petition and can invoke the statute. Hereinafter it will be referred to as the plaintiff.

It is settled that the common-law right of a stockholder to inspect the books of a corporation is a qualified and not an absolute right. *Varney v. Baker*, 194 Mass. 239, 80 N. E. 524, 10 Ann. Cas. 989. Where the right has been given by statute it has been decided in many jurisdictions that unless the statute imposes restrictions or limitations, the right is absolute, and the motive or purpose of the stockholder in seeking to exercise it is not the proper subject of judicial inquiry. *Foster v. White*, 86 Ala. 467, 6 South. 88; *Hobbs v. Tom Reed Gold Mining Co.*, 164 Cal. 497, 129 Pac. 781, 43 L. R. A. (N. S.) 1112; *Venner v. Chicago City Ry.*, 246 Ill. 170, 92 N. E. 643, 138 Am. St. Rep. 229, 20 Ann. Cas. 607; *White v. Manter*, 109 Me. 408, 84 Atl. 890, 42 L. R. A. (N. S.) 332; *Henry v. Babcock & Wilcox Co.*, 196 N. Y. 302, 89 N. E. 942, 134 Am. St. Rep. 835; *Cincinnati Volksblatt Co. v. Hoffmeister*, 62 Ohio St. 189, 56 N. E. 1033, 48 L. R. A. 732, 78 Am. St. Rep. 707; *Kimball v. Dern*, 39 Utah, 181, 116 Pac. 28, 35 L. R. A. (N. S.) 134, Ann. Cas. 1913E, 166; *Holland v. Dixon*, 37 Ch. D. 669; *Davies v. Gas Light & Coke Co.*, [1909] 1 Ch. 708; 20 Ann. Cas. 612, note; Ann. Cas. 1913E, 173, note.

The scope of our statute is narrower than the common-law right of inspection, as it deals only with the records, stock and transfer books. The present application is confined to the stock and transfer books and is made for the alleged purpose of obtaining a complete list of the stockholders and their residences. The right of a stockholder to obtain this information has been recognized by the Legislature of this commonwealth since 1858. See St. 1858, c. 144; Gen. St. c. 66, § 10; Pub. Sts. c. 105, § 21; R. L. c. 109, § 32. And by R. L. c. 110, § 51, every business corporation, excepting banks, steam and street railway and insurance companies, was required to make and file annually in the office of the secretary of the commonwealth a certificate, stating, among other things, the name of each shareholder and the number of shares standing in his name. Such certificates were considered as recorded, and were kept in book form convenient for reference. See 1 Opinions of the Atty. Gen. 278. The language of St. 1903, c. 437, § 30, and the history of the legislation on the subject indicate that the stockholder's right to know the names, addresses and extent of interest of his as-



sociates in the common enterprise, who with him must elect directors to manage the business of the company, is an absolute right.

As we construe the report, however, it is not necessary to decide whether a stockholder is entitled to the relief here asked for regardless of his motive or purpose. The single justice, after hearing the parties, ruled that the plaintiff should have the right to make the inspection prayed for. It is reasonably to be inferred that he was satisfied that the plaintiff was acting in good faith. The fact, if it is a fact, that Powelson, by reason of prior litigation, desires to change the administration of the company, and has instituted these proceedings with that in view, is entirely consistent with an honest belief that a change in management and policy will advance the interests of the corporation and his own rights as a stockholder. *Varney v. Baker*, 194 Mass. 239, 80 N. E. 524, 10 Ann. Cas. 989; *State v. Donnell Manuf. Co.*, 129 Mo. App. 206, 107 S. W. 1112; *Richardson v. Swift*, 7 Houst. (Del.) 137, 30 Atl. 781; *Phoenix Iron Co. v. Commonwealth*, 113 Pa. 563, 6 Atl. 75; *State v. Monida & Yellowstone Stage Co.*, 110 Minn. 200, 124 N. W. 971, 125 N. W. 676.

The right of the plaintiff to be represented by duly authorized attorney as incidental to the right of inspection has not been questioned. See *White v. Manter*, 109 Me. 408, 84 Atl. 890, 42 L. R. A. (N. S.) 332; *Foster v. White*, 86 Ala. 467, 6 South. 88; 10 Cyc. 958, note. And the ruling of the single justice authorizing the plaintiff to make written memoranda or copies of the stock and transfer books is in accord with sound reason and authority. *People v. Consolidated Nat. Bank*, 105 App. Div. 409, 94 N. Y. Supp. 173; *Cincinnati Volksblatt Co. v. Hoffmeister*, 62 Ohio St. 189, 56 N. E. 1033, 48 L. R. A. 732, 78 Am. St. Rep. 707; *State v. Bienville Oil Works*, 28 La. Ann. 204; *Henry v. Babcock & Wilcox Co.*, 196 N. Y. 302, 89 N. E. 942, 134 Am. St. Rep. 835; *State v. German Mut. Life Ins. Co.*, 169 Mo. App. 354, 152 S. W. 618; *Mutter v. Eastern & Midland Ry.*, 38 Ch. Div. 92.

The order for inspection is to issue as prayed for. The details as to time and manner will be designated in the order as settled by a single justice.

Ordered accordingly.

## PEOPLE ex rel. BRITTON v. AMERICAN PRESS ASS'N.

(Supreme Court of New York, Appellate Division, First Department, 1912.  
148 App. Div. 651, 133 N. Y. Supp. 216.)

Appeal from Special Term, New York County.

Mandamus by the People, on the relation of William R. Britton, against the American Press Association, to compel allowance of an inspection of defendant's stock book. From an order granting a peremptory writ, defendant appeals. Reversed, and motion denied.

SCOTT, J. This is an appeal from an order granting relator's mo-

tion for a writ of mandamus to compel the defendant corporation to permit him to inspect its stock book.

Plaintiff is the owner of five shares of stock of the defendant corporation, and has demanded and been refused the right to inspect its stock book. The defendant meets the application by the statement of certain facts leading to the conclusion that the application is made in the interest of a business rival of the defendant, and that relator's purpose in seeking an examination is, in the language of the justice at Special Term, "sinister and inimical to the defendant." The relator makes no denial of the facts stated by defendant, and no disclaimer of the purpose attributed to him, and we are therefore justified in assuming that his attitude is inimical to the defendant, and that his purpose is to injure it in some way through the possession of the information which he seeks. It is definitely settled that the motives of a stockholder, however sinister, constitute no answer to an action by him to recover the penalty prescribed by statute for the refusal of a corporation to exhibit its stock book upon a proper demand. The statute recognizes an absolute right in the stockholder, and imposes an absolute duty upon the corporation and the custodian of the stock book. *Henry v. Babcock*, 196 N. Y. 302, 89 N. E. 942, 134 Am. St. Rep. 835.

The case just cited establishes the absolute right of the stockholder either to be allowed an inspection, or, if that be denied him, to a recovery of the penalty prescribed by statute. The right to a mandamus to compel compliance with the statute is not, however, specifically given by the written law, and there still remains open the question whether or not, in a case like the present, the court will aid a stockholder in pursuing his sinister designs upon the corporation by issuing its writ of mandamus. It has repeatedly been held that it will not (*People ex rel. Althause v. Giroux Con. M. Co.*, 122 App. Div. 617, 107 N. Y. Supp. 188; *People ex rel. Hunter v. Nat. Park Bank*, 122 App. Div. 635, 107 N. Y. Supp. 369), and it would be unnecessary to further consider that question but for the fact that the court below was of the opinion, and counsel for the respondent strenuously argues, that in some way the decision by the Court of Appeals in *Henry v. Babcock* has overruled the cases last above cited.

In neither of those cases was any question made as to the mandatory nature of the statute relied upon. That was assumed and conceded. The only question considered and decided was as to the granting of a peremptory writ to enforce an absolute right sought to be enforced for a sinister purpose. That is to say, the only question was as to granting a particular and extraordinary remedy, and this question is not touched upon in *Henry v. Babcock*, and, so far as the Court of Appeals is concerned, remains an open question. It is true that relator has a strict and absolute legal right to inspect the stock book, but the mere existence of an undisputed right, although necessary to the granting of a mandamus, is not sufficient of itself to require the

issuance of the writ, for that still rests in the sound judicial discretion of the court. This has been the rule from the earliest times. So well established is it in this state that the granting or refusing of a writ of mandamus rests in the sound discretion of the Supreme Court that the Court of Appeals has uniformly refused to entertain appeals in such cases, unless it is made to appear that the discretion of the court has been abused. *Sage v. L. S. & M. S. R. Co.*, 70 N. Y. 220; *People ex rel. Lunney v. Campbell*, 72 N. Y. 496; *People ex rel. Faile v. Ferris*, 76 N. Y. 326; *In re Dederick*, 77 N. Y. 595; *People ex rel. Lentillon v. Coler*, 168 N. Y. 6, 60 N. E. 1046.

Doubtless the Legislature might have provided that a stockholder wrongly refused an inspection of a stock book might have a peremptory order in the nature of a mandamus to enforce his right, but it has not done so. In *Matter of Steinway*, 159 N. Y. 250, 53 N. E. 1103, 45 L. R. A. 461, Judge Vann, writing for the court, examined exhaustively the right of stockholders to examine the books of a corporation, including the right conferred by the statute now invoked by relator, and the authority of the Supreme Court to enforce that right by mandamus. His conclusion was thus expressed: "We think that the common-law right of a stockholder with reference to the inspection of the books of his corporation still exists, unimpaired by legislation; that the Supreme Court has power in its sound discretion upon good cause shown to enforce the right; and that such power is part of its general jurisdiction as the successor of the Courts of the Colony of New York, which had the jurisdiction of the Court of King's Bench and the Court of Chancery in England."

It is quite unnecessary to cite authorities to sustain the principle referred to by Judge Vann that the exercise of the jurisdiction to grant mandamus rests to a considerable extent, in the sound discretion of the court, and that in certain cases, although the applicant may have an undoubted legal right, and mandamus would be an appropriate remedy, still the court in the exercise of its sound discretion will refuse to issue the writ. Such a case is presented when the effect of the writ will be to enforce compliance with the strict letter of the law in disregard of its real spirit. See *High on Extraordinary Legal Remedies* (3d Ed.) § 9. We need not speculate as to the particular purpose sought to be gained by providing by statute that a stockholder shall have the right to inspect upon demand the stock book of his corporation. It is quite safe, however, to assume that the Legislature intended that the right should be exercised for the benefit of the corporation itself, or of its stockholder as such, and that it did not intend that it should be exercised for the destruction or serious injury of the corporation and its stockholders generally, as it is the apparent purpose of the present relator to use the information which he seeks. In reversing the order appealed from therefore, we are holding nothing contrary to what was decided by the Court of Appeals in *Henry v. Babcock*. On the contrary, we concede that relator has a strict legal right



to an inspection of the stock book. But, conceding that, following an unbroken line of authorities, we further hold that the application for a writ of mandamus is an appeal to our sound discretion, and that under the circumstances of the present case we should not exercise that discretion to issue the writ. The application and enforcement of this rule, as we conceive, will tend to carry into effect precisely what the Legislature intended. An applicant whose purposes are honest and who is not shown to be actuated by a sinister motive will have no difficulty in obtaining the inspection the statute allows him, while one who is shown to act from an improper motive will be relegated to the remedy which the statute itself provides.

For these reasons, the order appealed from will be reversed, with \$10 costs and disbursements, and the motion denied, with \$10 costs.

INGRAHAM, P. J., and MILLER, J., concur.

CLARKE, J. (dissenting). The appellant is a domestic corporation, having an office for the transaction of its business in the borough of Manhattan, and is not a moneyed corporation or a railroad corporation. The relator is the holder of record of a certificate for five shares of the capital stock of the defendant. As a stockholder he demanded an inspection of the stock book of appellant, and, having been refused, brought this proceeding to obtain a peremptory mandamus to compel the corporation to permit such inspection.

In the answering affidavits the appellant attempts to show that the application is not made in good faith and for legitimate purposes, but in the interests of an inimical business rival. The learned court below granted the application and stated in its opinion: "That the stockholder of a corporation has an absolute right to an inspection of the stock book without stating his intent." The corporation appeals.

Section 32 of the stock corporation law (chapter 59, Cons. Laws 1909; chapter 61, Laws of 1909) provides that: "Every stock corporation shall keep at its office \* \* \* a book to be known as the stock book, containing the names, alphabetically arranged, of all persons who are stockholders of the corporation, showing their places of residence, the number of shares of stock held by them respectively, the time when they respectively became the owners thereof, and the amount paid thereon. The stock book of every such corporation shall be open daily during at least three business hours for the inspection of its stockholders and judgment creditors, who may make extracts therefrom. \* \* \* Every corporation that shall neglect or refuse to keep or cause to be kept such books or to keep any book open for inspection as herein required, shall forfeit to the people the sum of \$50 for every day it shall so neglect or refuse. If any officer or agent of any such corporation shall \* \* \* neglect or refuse to exhibit the same or to allow them to be inspected and extracts taken therefrom, as provided in this section, the corporation and such officer or agent shall each forfeit and pay to the party injured a penalty of \$50

for every such neglect or refusal and all damages resulting to him therefrom."

Section 33 of the statute contains somewhat similar provisions affecting foreign stock corporations having an office for the transaction of business in this state.

It is true that in said section a penalty is provided for a violation of the provisions thereof, and it is also true that it is not specifically provided that a mandamus may be issued to compel the observance thereof. *People ex rel. Gunst v. Goldstein*, 37 App. Div. 550, 56 N. Y. Supp. 306, was an appeal from an order commanding the defendant, the secretary and treasurer of a corporation, to produce the stock book of the company, and to allow the relator to inspect and to make extracts therefrom. In affirming the order, Mr. Justice Barrett, speaking for a unanimous court, said: "Then, too, the relator's motives are of no moment. The defendant has no right to question them. The inspection of its books by the president of the company is a matter of right."

In *People ex rel. Callanan v. Keeseville, etc., R. Co.*, 106 App. Div. 349, 94 N. Y. Supp. 555, Mr. Justice Houghton, writing in the Third Department for a unanimous court, said: "We think his demand was sufficient, and that he had an absolute right of inspection, and that the peremptory writ of mandamus should have been granted. \* \* \* The motives of a stockholder in inspecting the stock book alone are immaterial. \* \* \* It was a privilege accorded him expressly by the statute and he should have been granted an inspection." And the order denying peremptory writ of mandamus was reversed; and the writ granted.

In *People ex rel. Fennelly v. Amalgamated Copper Co.*, 110 App. Div. 892, 96 N. Y. Supp. 1141, affirmed 184 N. Y. 573, 77 N. E. 1193, and *People ex rel. Fennelly v. United Copper Co.*, 110 App. Div. 892, 96 N. Y. Supp. 1141, affirmed 184 N. Y. 578, 77 N. E. 1194, orders directing a mandamus to compel inspection of the stock books were affirmed by this court and the Court of Appeals, in spite of voluminous allegations, as appears upon the inspection of the records in those cases, that the inspection was desired from selfish and improper motives. But in *People ex rel. Hunter v. National Park Bank*, 122 App. Div. 635, 107 N. Y. Supp. 369, writing for a divided court, Mr. Justice Ingraham held that the granting of a mandamus is always in the judicial discretion of the court, and that a strict legal right would not be enforced when it appeared that the application was not made in good faith for a legitimate and proper purpose.

*Henry v. Babcock & Wilcox Co.*, 196 N. Y. 302, 89 N. E. 942, 134 Am. St. Rep. 835, was an appeal from a judgment of the Appellate Division in the First Department in favor of defendant upon the submission of a controversy upon an agreed statement of facts. It is true that in that controversy was involved enforcement of the penalty provided by the statute for denial of the right to inspect, but this court

(125 App. Div. 538, 109 N. Y. Supp. 853), although greatly divided, applied the doctrine which it had announced in *People ex rel. Hunter v. National Park Bank*, *supra*, saying: "Whenever application is made to inspect and the motive of the applicant is questioned, he should make known what the motive is so that the person having the book in charge may refuse to produce it, if the purpose is to work an injury to the corporation or is purely personal to the applicant and not connected with any interest which he has in the corporation. Here the plaintiff knew what his motive was. He refused to disclose it, and it is fairly to be inferred from that fact that the motive was not a proper one." The court gave judgment for the defendant.

With the above cited cases all brought to the attention of the Court of Appeals, that court said: "No doubt the Legislature could make the stockholder's privilege of inspection dependent upon the motive or purpose with which it is sought; but it has not seen fit to do so. The language of the statute is plain and mandatory. It recognizes an absolute right in the stockholder, and imposes an absolute duty upon the corporation and the custodian of the stock book. The law requires no statement or proof of any particular intent upon the part of the person demanding the inspection. He must be a stockholder and must prefer his request during business hours; that is all. \* \* \* The plaintiff was refused any inspection at all in the absence of the disclosure of his purpose; and this action of the defendant has been sanctioned by the judgment of the Appellate Division. We think that judgment is based upon a mistaken construction of the statute in this respect." The judgment was reversed, and judgment directed for the plaintiff.

It will not do in my opinion to disregard the plain and emphatic language of the Court of Appeals upon the ground that it was obiter, that the proceeding before it was not mandamus. This precise statute was before it, and the judgment appealed from was based upon the prior decision of this court in mandamus proceedings, and upon the interpretation therein made of this statute, into which this court had read the requirement of establishing a proper motive or intent upon the part of the applicant to entitle him to inspect. That claim the Court of Appeals brushed away and held emphatically that the language of the statute is plain and mandatory. It recognizes an absolute right in the stockholder, and imposes an absolute duty upon the corporation. If that be so, mandamus is an appropriate remedy to enforce that absolute right and compel the performance of that absolute duty. For this court to refuse to enforce such a mandatory statute so interpreted by the court of last resort is to set up its discretion against the clearly expressed will of the Legislature, and in my judgment to reverse, in effect, the Court of Appeals.

I therefore vote to affirm the order appealed from, with costs and disbursements to the respondent.

LAUGHLIN, J., concurs.



## VII. Profits and Dividends \*

### SEARLES v. GEBBIE.

(Supreme Court of New York, Appellate Division, Fourth Department, 1906.  
115 App. Div. 778, 101 N. Y. Supp. 199.)

Appeal from Special Term, Herkimer County.

Action by George W. Searles against Frank Gebbie and others. From an interlocutory judgment overruling a demurrer to the complaint, defendants appeal. Reversed and demurrer sustained, with leave to plead over.

SPRING, J. The defendant Mohawk Condensed Milk Company is a domestic corporation with a paid-up capital stock of \$60,000, and the plaintiff is a stockholder thereof, owning stock of the par value of \$1,000, and until January, 1905, was one of the directors of the corporation. The other defendants are its present officers and directors.

A brief summary of the salient allegations of the complaint is necessary for a comprehension of the questions at issue on this appeal. On the 14th day of July, 1902, the directors of said corporation at a regular meeting declared a dividend of 50 per cent. on its capital stock, payable on the 1st of August thereafter. At the time of the declaration of the dividend there was on hand a surplus of net earnings of more than \$100,000, and in February, 1905, these earnings aggregated \$108,000. The plaintiff has not been paid his dividend of \$500, although he has demanded it, and he seeks to recover that sum of the corporation in this action. The complaint further alleges: That in 1905 the stockholders by resolution voted to increase the capital stock of said company to \$240,000, and the directors were ordered to take the legal proceedings essential to make effective this increase. The directors thereupon proceeded to provide for such increase by allowing those taking the new stock to do so at par, thus ignoring the "more than twice par" value of the present stock by reason of the existing surplus and which had been earned by the present capital. The directors in their plan of increase expect to allow each of the present stockholders to subscribe for three times his present holding of stock, paying therefor in cash, and the plaintiff was so advised and permitted to so subscribe for the \$3,000 of stock, which would represent his aliquot share of the increased capital. That the defendant directors have each subscribed for their shares of said increase and they control said corporation and own a majority of its stock. In January, 1905, the plaintiff was dropped from the directorship and there were other changes in that body, and the plaintiff charges that the election of new officers "was pursuant to

\* For discussion of principles, see Clark on Corp. (3d Ed.) §§ 136, 137.

a fraudulent agreement or understanding" among these majority stockholders to refuse to pay the said dividend, "and thereby to reappropriate said dividend to the company, and to share in said dividends and receive the benefits thereof, under their new subscription to increase the capital stock of the said company, their said new subscriptions being at par, whereas the old stock of said company is fully worth considerable more than \$200 on a share." That the plaintiff has "protested" against this proposed issue of new stock, and has requested the corporation to commence an action in equity to restrain its issue and also to require the corporation to pay the dividend declared, and upon refusal this action was commenced on his own behalf as a minority stockholder, and for the benefit of all other stockholders similarly situated who desire to participate therein. The relief asked for is the payment of the dividend to the plaintiff and to restrain the proposed increase of the capital stock. The defendants have demurred on the ground that there is an improper misjoinder of the causes of action, and also that no cause of action is stated against the defendants.

There is a clean cut cause of action at law set forth against the corporation. Upon the declaration of the dividend the sum of \$500 became due the plaintiff from the corporation. It became the debtor of the plaintiff. *Ehle v. Chittenango Bank*, 24 N. Y. 548; *Am. & Eng. Encyc. of Law*, vol. 9, p. 690 (2d Ed.). The directors were not personally chargeable with the payment of this dividend unless they converted it to their own use, or by some act changed their relation to it. At any time after the date fixed for the payment of the dividend the plaintiff could have maintained an action at law against the corporation to recover this sum. Nor was a suit in equity proper, for an adequate remedy at law existed, and the directors would not be proper parties defendant in an action to recover this sum. They are not the debtor, but the corporation is the party liable. Now, where the amount of the dividend has been segregated or set apart into a distinct fund for the purpose of paying the dividend and is within the dominion of the directors, who refuse to use it for the purpose intended, they become trustees of the fund, and an action in equity may be maintained to reach the fund and to charge the directors with official misconduct. *Le Roy v. Globe Ins. Co.*, 2 Edw. Chanc. Rep. 657; *King v. Patterson*, etc., *R. R. Co.*, 29 N. J. Law, 89.

The respondent's counsel relies upon the *Le Roy Case* cited to sustain the contention that the action in equity will lie to recover the dividend. In that action an insurance corporation declared a dividend in November payable the 1st of the following December. On the 30th of November the dividend was carried on the books of the company to the profit and loss account, thus severing it from the assets of the company. Notice was published that payment of the dividend would be made on and after December 1st and checks were drawn and signed



by the president to the order of the secretary, to whom they were delivered for indorsement and transfer to each stockholder as he called therefor. Four-fifths of the checks had been delivered, when, on the 16th of December, an extensive fire occurred in the city of New York, ruining the insurance company, and a receiver was appointed. The plaintiff was a stockholder and had not received his check dividend. He also had due him unearned premiums from a canceled policy of insurance. The receiver declined to pay the dividend or the premiums, and the stockholder commenced a suit in equity and recovered the dividend. The court held the action in equity was maintainable because the setting apart of the money to meet the dividend created a trust fund over which the officers of the company had control.

This case denotes the distinction between the liability at law of the corporation owing dividends to its stockholders and the money to pay which has never been severed from the mass of the corporate property, but to all intents and purposes remains a part of it, and the liability in equity of the directors who have set apart the money into a distinct fund to pay the dividends and who hold that fund as the trustees of the stockholders, but refuse to distribute it. This distinction is noted in *Lowne v. American Fire Insurance Co. et al.*, 6 Paige, 482. The complaint contains every allegation essential to constitute a perfect cause of action to recover this dividend of the corporation, and the facts alleged are supplemented in the demand for judgment that the corporation be required to pay the dividend with interest.

The other cause of action is distinctly one in equity. It charges the defendant directors with conspiring to increase the capital stock in an illegal and improper manner and for their own personal aggrandizement to the damage of the plaintiff and other minority stockholders, and asks that they be restrained from consummating the scheme. This remedy must primarily be at the instance of the corporation (*Flynn v. Brooklyn City R. R. Co.*, 158 N. Y. 493-508, 53 N. E. 520), and the pleader recognized this necessity, for he alleges demand and refusal on the part of the defendant corporation to bring the action. This action, therefore, is only maintainable by the corporation, or upon its refusal, by a complaining stockholder to restrain the perpetration of a fraud which will tend to diminish the value of the corporate assets. The payment of the dividend is in no way affected by the consummation of this scheme. The corporation would still be liable to the plaintiff, as it has been since August, 1902, and during the directorship of the plaintiff. We appreciate that in construing a complaint imputing fraud to directors and the gravamen of which is to enjoin them from carrying out some plan fraught with damage to other stockholders, an isolated fact here and there may not be culled from the pleading as indicating a purpose to unite actions improperly. *Bosworth v. Allen*, 168 N. Y. 159, 61 N. E. 163, 55 L. R. A. 751, 85 Am. St. Rep. 667; *Weber v. Wallerstein et al.*, 111 App. Div. 693, 97 N. Y. Supp. 846. And where there is plainly a single purpose to be



achieved in the complaint it may contain in a series of facts or circumstances enumerated sufficient allegations to constitute other causes of action, providing they are pertinent to and connected with the relief sought. But we think the present complaint cannot be brought within that rule. It alleges, with much particularity, the facts entitling the plaintiff to maintain an action at law to recover this dividend of the corporation, with a demand for money judgment. These facts are made prominent in the pleading and there is no averment connecting them with the conspiracy, which is the pith of the action in equity. A reading of the complaint impels the belief that it was intended to set forth two independent causes of action. No fraud is charged in the declaration of the dividend. No misappropriation of it is alleged. No culpability is ascribed to the directors in connection with it, except "to reappropriate" it to the company, which is intelligible, and no inability of the plaintiff to collect it is suggested. If the plan of increase in the capital stock is carried out, the plaintiff could still enforce the payment of his dividend. The omission to pay the dividend has no connection with the alleged fraudulent agreement of which he complains. The inception of the fraud is charged to have been at the time of the election of the directors in January, 1905, nearly two years and a half after the plaintiff's cause of action to collect the dividend had accrued. We think two causes of action were improperly united.

The complaint contains the facts to some extent upon which the alleged agreement to defraud is founded. Whether the plan is of the dishonest character claimed by the plaintiff depends upon the construction to be put upon these several facts, and we are not disposed now to hold they may not be sufficient to constitute a cause of action. Their effect can be determined much more satisfactorily when the evidence has been presented. The charges of the fraudulent agreement are sweeping and consist too much in conclusions, but we cannot say that a construction may not be given to the facts which are alleged supporting the imputation of fraud.

The interlocutory judgment should be reversed, with costs and disbursements of this appeal, and the demurrer sustained, with costs, with leave to the plaintiff to plead over, etc. All concur, except McLennan, P. J., who dissented in an opinion in which WILLIAMS, J., concurred.<sup>10</sup>

<sup>10</sup> The dissenting opinion of McLennan, P. J., is omitted. The judgment of the Appellate Division was affirmed without opinion. 190 N. Y. 533, 83 N. E. 1131.

## In re OSBORNE.

(Court of Appeals of New York, 1913. 209 N. Y. 450, 103 N. E. 723, 50 L. R. A. [N. S.] 510, Ann. Cas. 1915A, 298.)

Appeal from Supreme Court, Appellate Division, Second Department.

Proceeding for the judicial settlement of the account of James W. Osborne, as executor and trustee under the will of Eugene La Grove, deceased. From part of an order of the Surrogate Court confirming the report of a referee, and from part of the court's decree, affirmed by the Appellate Division, Second Department (153 App. Div. 312, 138 N. Y. Supp. 18), the executor and trustee appeals. Modified and affirmed.

CHASE, J.<sup>11</sup> Eugene La Grove died a resident of this state October 4, 1908, leaving a will which was duly probated and by the fourth paragraph of which a trust was created as follows: "All the rest, residue and remainder of my property and estate, real, personal and mixed of every description and wheresoever situated of which I may die seized or possessed \* \* \* I give, devise, and bequeath to my executor and trustee hereinafter named in trust, to hold said property and estate and invest and reinvest the same and to collect the rents, issues, income and profits therefrom, and to pay the net rents, issues, income and profits therefrom quarterly to my wife, Ivy Lee La Grove from the time of my death during the term of her natural life, and, upon her death, to divide the principal into as many shares as my wife shall leave children by our marriage her surviving \* \* \* but in the event that my said wife shall die leaving no issue her surviving, then at her death the principal so set apart for her benefit shall be paid to such person or persons as would be entitled to share in her estate were she to die intestate under the statute of distribution in force at the time of her death in the state of New York." The testator did not leave any descendants. Ivy Lee La Grove, who was his wife, is living, the rest, residue, and remainder of the property, as provided by the fourth paragraph of the will, is held in trust by James W. Osborne as trustee pursuant to the provisions of such paragraph.

The will also provides in the fifth paragraph thereof as follows: "I hereby request my executor and trustee under this my will not to sell any stocks that I may hold at the time of my death in the Singer Manufacturing Company, unless the remainder of my property and estate is insufficient to pay my just debts and funeral expenses and the specific legacies and charges in this my will contained; and in case such remainder of my estate is insufficient to pay such debts and funeral expenses and the specific legacies in this my will contained, then and in that event I request my executor to sell only so much of the

<sup>11</sup> Portions of the opinion and all of the dissenting opinion of Gray, J., are omitted.

stock of said company as is necessary to be sold in order to pay such debts, legacies and charges. I authorize, however, my executor and trustee created under this my will that should he so elect, he may sell said stock or any of the same and in his discretion change the investment of said trust funds and should my executor and trustee elect to sell said stock or any part thereof, that he shall at all times keep the proceeds thereof as well as any other part of the trust funds herein devised or bequeathed invested in stocks and bonds of the United States or of the state of New York and such stocks and bonds or other investments as may be at the time legal investments for trust funds in the state of New York."

The principal part of the estate of the testator consisted of 3,000 shares of the stock of the Singer Manufacturing Company, a corporation organized and existing under the laws of the state of New Jersey. The capital stock of the Singer Manufacturing Company at the time of the death of the testator was \$30,000,000. On that day it had a surplus of accumulated earnings arising exclusively from the business of the company amounting to \$37,604,206. On June 17, 1910, such surplus had increased to \$51,560,757. On March 31, 1910, the executor sold 80 shares of the stock of said company. On June 2, 1910, the board of directors of said company passed a resolution as follows: "Whereas this corporation now has a capital stock of thirty millions of dollars issued and outstanding and a surplus of thirty millions of dollars and upwards, and, whereas, it is desirable that said surplus to the extent of at least thirty millions\* of dollars should be retained by the corporation as working capital, and to that end that its capital stock should be increased to sixty millions of dollars and a stock dividend of thirty millions of dollars be declared out of such increase, therefore, be it resolved: First. That it is advisable to increase the capital stock of this corporation to sixty millions of dollars, and Second. That it is advisable to declare and pay to the stockholders of the corporation a stock dividend of thirty millions of dollars out of such increase of stock. And the board does hereby call a special meeting of the stockholders to be held at the company's office at the Singer Building in the city of Elizabeth on the sixteenth day of June, 1910, at three o'clock in the afternoon, to take action upon the above resolution and decide whether or not such increase of stock shall be made."

On said 16th day of June, 1910, the stockholders adopted a resolution as follows: "Resolved, that the directors be and they hereby are authorized and empowered to forthwith declare a stock dividend of thirty millions of dollars, or one hundred per cent on the present issued capital stock of this company, and to issue forthwith in payment thereof certificates of fully paid nonassessable stock, to the stockholders of record at this date, in the amounts in which they are respectively entitled to the same."



On June 17, 1910, the board of directors of said company adopted a further resolution as follows: "Resolved that the directors declare and they do now declare a stock dividend of thirty millions of dollars, or one hundred per cent on the present issued capital stock of this company payable forthwith to the stockholders of record on the 16th day of June instant out of said increase of stock, and that the president and treasurer be and they hereby are authorized and directed to issue forthwith to the several stockholders of record on the said 16th day of June instant, certificates for so many shares of fully paid and non-assessable stock as said shareholders shall severally be entitled to in payment of said dividends." Thereupon, and on the same day, June 17, 1910, said company paid over and delivered to James W. Osborne as such executor a stock dividend of 2,920 shares of the par value of \$100 each, being one share of increased capital stock of said company for each share of old stock theretofore held by said Osborne as executor, and said stock remains in the possession of said Osborne as such executor and trustee.

After the death of La Grove, and prior to the payment to Osborne as such executor of the stock dividend, regular cash dividends had been paid on said stock amounting in the aggregate to \$242,564.18, which has been paid from time to time by said executor to said Ivy Lee La Grove, the beneficiary under the trust, as provided by said will.

The troublesome question as to who is entitled to extraordinary dividends declared upon stock held in trust as between life beneficiaries under the trust and the remaindermen is again presented to us for our consideration.

The question has been considered by the courts in this and other states and countries in many and various forms from time to time since the decisions and opinions of the courts have been published. It has been said that no question before the courts has been more troublesome. Certainly none has resulted in greater contrariety of views. Decisions that are apparently contradictory either in the same court or in the courts of different states and countries have, however, been caused in part by different facts and circumstances existing in the cases decided, and the effect necessarily given to the language of the will or instrument creating the trust in the particular cases in which the decisions have been rendered.

In determining who is entitled to a dividend upon stock held in trust, the intention of the testator or the maker of the trust must be carried out when such intent is clear, so far as such intent does not result in an unlawful accumulation of income. Very many cases arise, however, where the testator or maker of the trust had not considered the possibility of enormous dividends being declared by corporations to effectuate their reorganization or in the division of accumulated profits, made necessary by new statutes, changed circumstances, and modern rules and conditions, or, if such testator or maker of the trust

had considered such possibility, he failed to express himself in the instrument creating the trust so as to show any clear intention regarding the same.

In England, as far back as 1799, it was established as a rule that all extraordinary or unusual dividends declared during the continuation of a life estate, whether payable in cash or in stock, belong to the corpus of the fund and not to the income. *Brander v. Brander*, 4 Ves. Jr. 800. The decision in the case cited was repeatedly followed and the rule restated. The rule in England as stated in the earlier cases has been materially modified, and dividends of cash are now held to belong to the life tenant and stock dividends to the remainderman, subject, perhaps, to an examination of the facts and circumstances in each case in applying the rule as stated. *Bouche v. Sproule*, L. R. (12 App. Cas.) 385.

In Massachusetts, in *Minot v. Paine*, reported in 99 Mass. 108, 96 Am. Dec. 705, it is said: "A simple rule is to regard cash dividends, however large, as income; and stock dividends, however made, as capital." The courts of that state have followed such rule, taking unto themselves, however, the right to determine whether a stock dividend is in effect a distribution of cash to be treated the same as a cash dividend.

In Pennsylvania it was held in *Earp's Appeal*, reported in 28 Pa. 368, that ordinary dividends on stock held in trust belong to the person entitled to the income of the trust fund, but that extraordinary dividends should be apportioned between the life estate man and the remainderman in accordance with the amount thereof accumulated before and after the creation of the trust.

The question has been considered by the courts of nearly every state in the Union and by the federal courts. It would be quite impossible to reconcile the many reported decisions. An effort to determine the weight of authority would be difficult, and extend this opinion to unjustifiable length. \* \* \*

The extended statement of the principal and most frequently quoted decisions in this state relating to the question involved has seemed necessary because of the difference of opinion expressed by counsel relating thereto. It will be seen that the earlier and also the latest decisions in this state clearly recognize and assert that where extraordinary dividends intrench upon the capital of the trust fund they should be returned to such trust fund so far as necessary to preserve the same. Recognizing as we must that a testator or maker of a trust may, if he chooses, provide that a part of the principal of a trust fund be paid to a life beneficiary of the trust, and that the courts must carry out such intention, all of the decisions in this state can be sustained without violating the right when it is not so controlled by the instrument creating the trust, to have the principal of the trust fund kept unimpaired by the division of accumulated surplus among life beneficiaries.

It is conceded that the capital of a corporation cannot be divided among the life beneficiaries. It is not alone the capital of the corporation that should be preserved, but the capital of the trust fund, whether invested by the trustees in stocks of corporations at a premium, or acquired from the testator or maker of the trust. The surplus of the corporation existing at the formation of the trust or when the stock is purchased represents a part of the capital of the estate as fully as does the capital of the corporation. The division by corporations of their surplus, accumulated through a long period of years in very large amounts, is now comparatively common, when until within a very recent time such division of enormous amounts was seldom, if ever, made.

Recently a well-known bank in this state with a capital of \$300,000 and a large surplus divided its surplus by declaring an extra dividend of \$2,700,000, or 900 per cent, and increased its capital stock to \$3,000,000, allowing its stockholders to subscribe for the increase and pay for the same by the dividend thus declared.

Another well-known bank in this state with a capital of \$500,000 and a very large surplus divided its surplus by declaring an extra dividend of \$9,500,000, or 1900 per cent., and increased its capital stock to \$10,000,000, allowing its stockholders to subscribe for the increase and to pay for the same by the dividend thus declared. Instances of the declaration of very large extraordinary dividends by corporations within the last few years could be multiplied in great numbers.

We refer to these cases simply to illustrate the great injustice that may be done to the ultimate beneficiaries of a trust fund if a large part of such fund as invested must necessarily, by reason of an extraordinary dividend and an arbitrary rule, be paid over to the life beneficiaries of the trust. If dividends by a corporation payable out of surplus earnings whenever accumulated must be paid to the life beneficiaries of the trust unless special provision to the contrary is made in the will or instrument creating the trust, it will make the retention or purchase of stocks by a trustee in corporations having a large surplus a matter of questionable propriety. It must also be remembered that if all such dividends are adjudged to constitute income as a matter of law, then their retention in the trust, even by direction of the testator or maker of the trust, would, in many instances, amount to an unlawful accumulation of income.

We think that in each case the court should look into the facts, circumstances, and nature of the transaction and determine the nature of the dividend and the rights of the contending parties according to justice and equity.

In Cook on Corporations (6th Ed.) c. 33, § 552, it is said: "Where shares of stock are held by an estate, and the income of the estate is to go to a life tenant for life, and the remainder to another party, the question of whether the life tenant or the remainderman is entitled



to a stock dividend or extraordinary cash dividend is a perplexing one. The stock dividend or extraordinary cash dividend may represent profits which were earned or accumulated before the life tenancy began. In that case it is clear that in justice the remainderman should receive it. If, however, it was earned after the life tenancy began, it is clear that the life tenant should have it. If it was earned partly before and partly after the life tenancy began, then it is apparent that in justice some apportionment should be made if possible."

In Thompson on Corporations (2d Ed.) § 5414, it is said: "The courts now inquire into the actual nature and source of dividends for the purpose of determining their character, and, as between the life tenant and remainderman, if they are found to represent earnings that accrued prior to the creation of the trust, they belong to the corpus of the trust; or if they represent the natural growth and increase in the value of the corporate plant and business, whether that growth and increase took place before or after the trust was created, they are to such extent capital. The court, in making the inquiry, concerns itself with the substance of the transaction, and not the form in which the corporation has seen fit to clothe it, and the fact that a dividend is distributed in cash or stock is said to be of little importance in determining whether it is capital or income. \* \* \* The object of the inquiry in every case should be to do justice to the life tenant and remainderman, and at the same time effectuate the intention of the creator of the trust; and on this theory in order to effectuate such intention and to do justice between the parties, a court may, under the circumstances of a given case, apportion a dividend between the life tenant and the remainderman."

It is manifest that any apportionment of a dividend is more or less troublesome in the practical handling of trust estates. It may be necessary in many cases to make the apportionment of dividends in an accounting by the trustee where all the parties interested are bound thereby. The dividends usually declared by corporations are the ordinary dividends such as are declared from year to year or at other regular dividend periods. Extraordinary dividends are the exception. In all cases of ordinary dividends the courts uniformly hold that they should be paid to the life beneficiary of the trust in conformity with the general rule that dividends are deemed to have been earned as of the date of their declaration. In cases of extraordinary and unusual dividends declared in whole or in part from earnings actually accumulated prior to the creation of the trust or the purchase of the stock, an adherence to the rule that dividends are deemed to have been earned as of the date of their declaration in many cases shocks the sense of justice.

Notwithstanding the difficulty in many cases of apportioning dividends, it is wiser and better to leave an apportionment to courts of equity, in preference to adhering to a rule that depends more upon its

simplicity and convenience of enforcement than upon justice and right. The distinction between ordinary and extraordinary dividends is necessary to make a workable rule, and at the same time preserve the integrity of the trust fund. The integrity of the trust fund and rights of the life beneficiary under the trust should each be considered, determined, and preserved by a court of equity. As far as the courts in this state have made statements to the contrary, it has been in opinions where such statements have been unnecessary to the determination of the case then under consideration, and such statements are disapproved. It should be held: (1) Ordinary dividends, regardless of the time when the surplus out of which they are payable was accumulated, should be paid to the life beneficiary of the trust. (2) Extraordinary dividends, payable from the accumulated earnings of the company, whether payable in cash or stock, belong to the life beneficiary, unless they intrench in whole or in part upon the capital of the trust fund as received from the testator or maker of the trust or invested in the stock, in which case such extraordinary dividends should be returned to the trust fund or apportioned between the trust fund and the life beneficiary in such a way as to preserve the integrity of the trust fund.

It has been argued that the will in this case as quoted shows that the testator intended that the value of the stock of the Singer Manufacturing Company owned by him at his decease should be preserved inviolate, and it is also argued that it was not the intent of said corporation, as shown by the resolution quoted, to distribute the surplus of the corporation, but to capitalize it so that thereafter it should be incapable of distribution. It is not necessary to discuss the question so presented, in view of the decision that we are making herein.

This case is one that requires an apportionment of the dividend. There is no dispute about the portion thereof that was earned prior to the creation of the trust, and the decree of the surrogate and order of the Appellate Division should be modified so as to award <sup>13956551/51560757</sup> parts of the stock dividend to the respondent, and directing that the remainder thereof be retained as a part of the capital of the trust fund, and, as thus modified, the order and decree should be affirmed, with costs to the appellant and respondent payable out of the estate.

CULLEN, C. J., and WILLARD BARTLETT, CUDDEBACK, HOGAN, and MILLER, JJ., concur with CHASE, J. GRAY, J., reads dissenting opinion.

## BALLANTINE v. YOUNG.

(Court of Chancery of New Jersey, 1911. 79 N. J. Eq. 70, 81 Atl. 119.)

Bill for directions by Jeanette Ballantine and others, as trustees of the will of John Ballantine, against Alice J. Young and others. Instructions given.

STEVENS, V. C. This is a bill filed by trustees of the will of John Ballantine, asking for directions.

The testator owned 25 shares of the Central Trust Company of the par value of \$50 each. Its capital stock was \$1,000,000. Its undivided surplus at the time of testator's death (April 27, 1895), \$5,776,113.70. It paid regular semiannual dividends at the annual rates of, first, 50 per cent., then 60 per cent., and then 80 per cent. On April 28, 1909, the surplus had increased to \$15,579,696.65. In June 1909, its capital stock, by appropriate action on the part of the directors and stockholders, was increased to \$3,000,000. The stockholders were given the right to subscribe at par for the new issue of \$2,000,000; that is, each stockholder might subscribe for two new shares for every old one he held. Contemporaneously a special or cash dividend of 200 per cent. was declared. The trustees took this dividend and used it to pay for the new stock, which stock they still hold.

By his will, testator gave his residuary estate to trustees in trust (speaking generally) to pay over a part of the income to his children during their respective lives, and at their deaths to divide certain parts of the principal among his grandchildren.

The first question is, Who is entitled to the dividend of the Central Trust Company issued under the circumstances above described, the life tenants or the remaindermen?

It seems to me plain that the dividend is a cash dividend, and not a so-called stock dividend. There is nothing, either in the substance or form of the transaction, that indicates that it was other than what it purports to be. *Gray v. Hemenway*, 206 Mass. 126, 92 N. E. 31, 138 Am. St. Rep. 377. It is true that the company at the time it declared the dividend gave an option to subscribe to the new stock, and that its officers anticipated that the new stock would be paid for with the cash dividend; but it did not attempt to compel the subscription. The stockholder could do as he pleased. He would, almost as a matter of course, elect to take the stock with the money thus provided; for the stock was selling for many times more than its par value.

Ordinary cash dividends go, of course, to the life tenant. Is this an ordinary or an extraordinary dividend? It seems to be extraordinary for three reasons: (1) It was declared in addition to the regular dividend; (2) it was much larger, exceeding the net profits made in the preceding year; and (3) it was evidently made for the special purpose of enabling the stockholders to avail themselves of the new subscription. If these concurring circumstances do not make the dividend



extraordinary for the purpose of apportionment, I do not know what could make it so. The distinction has been adverted to, apparently with approval, by the Court of Errors, in the Lang Case, 57 N. J. Eq. 326, 41 Atl. 705, and I do not feel at liberty to disregard it. I, therefore, think, on the doctrine of that case, that the dividend is apportionable between principal and income in the ratio that the surplus at testator's death bears to the surplus accumulated thereafter up to the time the dividend was declared.

The trustees, as a matter of fact, took the dividend and invested it in the new shares, which sell at a very large premium. They were justified in doing so. *Bouch v. Sproule*, 12 App. Cas. 385; *Malam v. Hitchens* (1894) 3 Ch. 578; and so the next question is, To whom does this premium belong? To the life tenant, or to the remaindermen? It has been held repeatedly that the right to subscribe for new shares which command a premium is a part of the principal, and belongs to the latter. *De Koven v. Alsop*, 205 Ill. 309, 68 N. E. 930, 63 L. R. A. 587; *Davis v. Jackson*, 152 Mass. 58, 25 N. E. 21, 23 Am. St. Rep. 801; *Greene v. Smith*, 17 R. I. 28, 19 Atl. 1081; *Hite v. Hite*, 93 Ky. 257, 20 S. W. 778, 19 L. R. A. 173, 40 Am. St. Rep. 189; *Eisner's Appeal*, 175 Pa. 143, 34 Atl. 577; *Richmond v. Richmond*, 123 App. Div. 117, 108 N. Y. Supp. 298; *Brown v. Brown*, 72 N. J. Eq. 667, 65 Atl. 739. That the trustees have actually subscribed for and taken the shares cannot alter the legal rights of the parties. By giving the life tenant a charge upon the stock thus held, for his proportion of the cash dividend (*Malam v. Hitchens*, *supra*), the relative rights of the parties are easily adjusted. So much of it as may be needed will be sold to satisfy the charge.

The next question is whether the trustees have the right to hold the stock that may remain unsold after the charge is satisfied. It seems to me that, having the right to take the stock, which, after it was taken, gave them no greater interest in the company than they had before—merely changed the form of their holding—they have the right to retain it. The authority given by the will is "to continue any investments or securities." By agreeing to take the company's stock in exchange for the company's money, they are merely preserving their proportionate interest in the property, and so doing nothing more than continuing their investment in it.

The next question relates to the so-called 15 per cent. stock dividend of the Delaware, Lackawanna & Western Railroad Company. This represents surplus earnings invested in the stock of two branch roads, now merged with the main road, and about \$3,000,000, applied in 1907, to the payment of maturing bonds issued as part of the capitalization. The whole sum represents surplus permanently devoted to capital account. To whom does this dividend belong? It is strongly contended that it belongs to principal. I feel compelled, however, by the state of the authorities to hold that it is, in part, income, and that it should be apportioned between the life tenant and the remaindermen. While the

case of *Van Doren v. Olden*, 19 N. J. Eq. 176, 97 Am. Dec. 650, was somewhat, in other respects, shaken by the decision in the *Lang Case*, it was not disapproved on this point. On the contrary, it was, apparently without much or any discussion, followed by the Court of Errors in *Ashhurst v. Potter*, 29 N. J. Eq. 625. While this latter case stands, there cannot be any doubt as to what this court must do. Since it was decided, the question has undergone discussion by the Supreme Court of the United States, in *Gibbons v. Mahon*, 136 U. S. 549, 10 Sup. Ct. 1057, 34 L. Ed. 525, and by the courts of last resort in England, in Massachusetts, in Illinois, and other New England States, in all of which it has been held that issues of stock based on earnings are part of the principal. On the other hand, the Court of Appeals of New York, in *McLouth v. Hunt*, 154 N. Y. 179, 48 N. E. 548, 39 L. R. A. 230, and some Western and Southern state courts have followed Pennsylvania in giving stock dividends to the life tenant. As a matter of logic, it is difficult to resist the reasoning leading to the conclusion that stock dividends are, in fact, principal; for the life tenant, as is universally held, is not, in the absence of fraud, or improper conduct, entitled to the earnings until they are distributed. They are not, in fact, distributed, but, on the contrary, put permanently into capital account when new stock is, without any money equivalent, allotted to the whole body of stockholders. But discussion is out of place, for *Ashhurst v. Potter* is, as I have said, controlling. I would merely add that in most cases, at least, stock dividends can hardly be called regular or ordinary dividends. They must, as a rule, be extraordinary. They represent no particular part of the earnings or surplus. Like all the other stock, they represent, not only surplus, but the entire property of the company. Being extraordinary, they must, according to the rule of the *Lang Case*, be apportioned where there has been a surplus accumulated before testator's death.

I think, in the absence of fraud, or some very special circumstance, the apportionment should be made on the basis of the company's accounts. To apportion them according to the judgment of an expert or of the court, as to whether the various items of disbursement are chargeable to current or capital, would be practically impossible. Proof on the one side would necessitate proof on the other. Even if the court, in the case of a foreign corporation, had power to compel exhibition of a multitude of items, stretching perhaps over a series of years, the length of time required for the examination, the expense of it, the doubt, after all, whether items (e. g., relating to the cost of new bridges, new rails, new machinery, new equipment) were properly chargeable to one account or the other, or, if to both, in what proportion, would of themselves be prohibitive of the inquiry.

I have discussed another phase of the question of stock dividends in *Day v. Faulks*, 79 N. J. Eq. 66, 81 Atl. 354, in an opinion filed contemporaneously with this. What I said in that case may, to a certain extent, apply here. For the reasons already given, the extraordinary

cash dividend of 50 per cent. paid by the Delaware, Lackawanna & Western Railroad Company must also be apportioned.

The option to subscribe to shares of the coal company is evidently capital. It was the right to purchase on favorable terms a new thing. If an option to subscribe to new stock of a corporation, whose stock the trustees hold, is capital, so, a fortiori, is an option to purchase stock they do not hold.

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### VIII. Increase of Capital Stock—Shareholders' Right to Preference<sup>12</sup>

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#### STOKES v. CONTINENTAL TRUST CO.

(Court of Appeals of New York, 1906. 186 N. Y. 285, 78 N. E. 1090, 12 L. R. A. [N. S.] 969, 9 Ann. Cas. 738.)

Appeal from an order of the Appellate Division of the Supreme Court in the first judicial department, entered January 4, 1905, reversing a judgment in favor of plaintiff entered upon a decision of the court on trial at Special Term and granting a new trial.

This action was brought by a stockholder to compel his corporation to issue to him at par such a proportion of an increase made in its capital stock as the number of shares held by him before such increase bore to the number of all the shares originally issued, and in case such additional shares could not be delivered to him for his damages in the premises.

The defendant is a domestic banking corporation in the city of New York, organized in 1890, with a capital stock of \$500,000, consisting of 5,000 shares of the par value of \$100 each. The plaintiff was one of the original stockholders and still owns all the stock issued to him at the date of organization, together with enough more acquired since to make 221 shares in all. On the 29th of January, 1902, the defendant had a surplus of \$1,048,450.94, which made the book value of the stock at that time \$309.69 per share. On the 2nd of January, 1902, Blair & Company, a strong and influential firm of private bankers in the city of New York, made the following proposition to the defendant: "If your stockholders at the special meeting to be called for January 29th, 1902, vote to increase your capital stock from \$500,000 to \$1,000,000 you may deliver the additional stock to us as soon as issued at \$450 per share (\$100 par value) for ourselves and our associates, it being understood that we may nominate ten of the 21 trustees to be elected at the adjourned annual meeting of stockholders."

The directors of the defendant promptly met and duly authorized a

<sup>12</sup> For discussion of principles, see Clark on Corp. (3d Ed.) §§ 138-141.



special meeting of the stockholders to be called to meet on January 29th, 1902, for the purpose of voting upon the proposed increase of stock and the acceptance of the offer to purchase the same. Upon due notice a meeting of the stockholders was held accordingly, more than a majority attending either in person or by proxy. A resolution to increase the stock was adopted by the vote of 4,197 shares, all that were cast. Thereupon the plaintiff demanded from the defendant the right to subscribe for 221 shares of the new stock at par, and offered to pay immediately for the same, which demand was refused. A resolution directing a sale to Blair & Company at \$450 a share was then adopted by a vote of 3,596 shares to 241. The plaintiff voted for the first resolution but against the last, and before the adoption of the latter he protested against the proposed sale of his proportionate share of the stock and again demanded the right to subscribe and pay for the same, but the demand was refused.

On the 30th of January, 1902, the stock was increased, and on the same day was sold to Blair & Company at the price named. Although the plaintiff formally renewed his demand for 221 shares of the new stock at par and tendered payment therefor, it was refused upon the ground that the stock had already been issued to Blair & Company. Owing in part to the offer of Blair & Company, which had become known to the public, the market price of the stock had increased from \$450 a share in September, 1901, to \$550 in January, 1902, and at the time of the trial, in April, 1904, it was worth \$700 per share.

Prior to the special meeting of the stockholders, by authority of the board of directors a circular letter was sent to each stockholder, including the plaintiff, giving notice of the proposition made by Blair & Company and recommending that it be accepted. Thereupon the plaintiff notified the defendant that he wished to subscribe for his proportionate share of the new stock, if issued, and at no time did he waive his right to subscribe for the same. Before the special meeting, he had not been definitely notified by the defendant that he could not receive his proportionate part of the increase, but was informed that his proposition would "be taken under consideration."

After finding these facts in substance, the trial court found, as conclusions of law, that the plaintiff had the right to subscribe for such proportion of the increase, as his holdings bore to all the stock before the increase was made; that the stockholders, directors and officers of the defendant had no power to deprive him of that right, and that he was entitled to recover the difference between the market value of 221 shares on the 30th of January, 1902, and the par value thereof, or the sum of \$99,450, together with interest from said date. The judgment entered accordingly was reversed by the Appellate Division, and the plaintiff appealed to this court, giving the usual stipulation for judgment absolute in case the order of reversal should be affirmed.

VANN, J.<sup>13</sup> No exception worthy of notice appears in the record,

<sup>13</sup> A portion of the opinion is omitted.

except those filed to the conclusions of law found by the trial judge. If those conclusions are supported by the facts found, the Appellate Division had no power to reverse the judgment rendered by the Special Term on questions of law only, as, from the silence of the record, it must be presumed was done. Code Civ. Proc. § 1338. If the facts found did not warrant the legal conclusions of the trial court the order of reversal was right and should be affirmed. Thus the question presented for decision is whether according to the facts found the plaintiff had the legal right to subscribe for and take the same number of shares of the new stock that he held of the old?

The subject is not regulated by statute and the question presented has never been directly passed upon by this court, and only to a limited extent has it been considered by courts in this state. *Miller v. Illinois Central R. R. Co.*, 24 Barb. 312; *Matter of Wheeler*, 2 Abb. Prac. (N. S.) 361; *Currie v. White*, 45 N. Y. 822.

In the first case cited judgment was rendered by a divided vote of the General Term in the first district. The court held that the plaintiff was entitled to no relief because he did not own any shares when the new stock was issued but only an option, and that he could not claim to be actual holder until he had exercised his right of election. The court further said, however, that if he was the owner of shares at the time of the new issue he had no absolute right as such owner to a distributive allotment of the new stock.

*Matter of Wheeler* was decided by Judge Mason at Special Term, and although the point was not directly involved, the learned judge said: "As I understand the law all these old stockholders had a right to share in the issuing of this new stock in proportion to the amount of stock held by them. And if none of the stock was to be apportioned to the old stockholders, they had certainly the right to have the new stock sold at public sale, and to the highest bidder, that they might share in the gains arising from the sale. In short, the old stockholders, as this was good stock and above par, had a property in the new stock, or a right at least to be secured the profits to be derived from a fair sale of it if they did not wish to purchase it themselves; and they have been deprived of this by the course which these directors have taken with this new stock by transferring or issuing it to themselves and others in a manner not authorized by law."

In *Currie v. White* the point was not directly involved, but Judge Folger, referring to the rights acquired under a certain contract, said: "One of these rights was to take new shares upon any legitimate increase of the capital stock, which right attaches to the old shares, not as profit or income, but as inherent in the shares in their very creation," citing *Atkins v. Albree*, 12 Allen (Mass.) 359; *Brander v. Brander*, 4 Ves. 800, and notes (Sumner Ed.). While this was said in a dissenting opinion, Judge Rapallo, who spoke for the court, concurred, saying, "As to the claim for the additional stock, I concur in the conclusions of my learned Brother Folger." The fair implication from both

opinions is that if the plaintiff had preserved his rights, he would have been entitled to the new stock.

In other jurisdictions the decisions support the claim of the plaintiff with the exception of *Ohio Insurance Co. v. Nunnemacher*, 15 Ind. 294, which turned on the language of the charter. The leading authority is *Gray v. Portland Bank*, decided in 1807 and reported in 3 Mass. 364, 3 Am. Dec. 156. In that case a verdict was found for the plaintiff, subject, by the agreement of the parties, to the opinion of the court upon the evidence in the case whether the plaintiff was entitled to recover, and, if so, as to the measure of damages. The court held that stockholders who held old stock had a right to subscribe for and take new stock in proportion to their respective shares. As the corporation refused this right to the plaintiff he was permitted to recover the excess of the market value above the par value, with interest. In the course of its argument the court said: "A share in the stock or trust when only the least sum has been paid in is a share in the power of increasing it when the trustee determines or rather when the cestuis que trustent agree upon employing a greater sum. \* \* \* A vote to increase the capital stock, if it was not the creation of a new and disjointed capital, was in its nature an agreement among the stockholders to enlarge their shares in the amount or in the number to the extent required to effect that increase. \* \* \* If from the progress of the institution and the expense incurred in it any advance upon the additional shares might be obtained in the market, this advance upon the shares relinquished belonged to the whole, and was not to be disposed of at the will of a majority of the stockholders to the partial benefit of some and exclusion of others."

This decision has stood unquestioned for nearly a hundred years and has been followed generally by courts of the highest standing. It is the foundation of the rule upon the subject that prevails, almost without exception, throughout the entire country. \* \* \*

If the right claimed by the plaintiff was a right of property belonging to him as a stockholder he could not be deprived of it by the joint action of the other stockholders and of all the directors and officers of the corporation.

What is the nature of the right acquired by a stockholder through the ownership of shares of stock? What right can he assert against the will of a majority of the stockholders and all the officers and directors? While he does not own and cannot dispose of any specific property of the corporation, yet he and his associates own the corporation itself, its charter, franchises and all rights conferred thereby, including the right to increase the stock. He has an inherent right to his proportionate share of any dividend declared, or of any surplus arising upon dissolution, and he can prevent waste or misappropriation of the property of the corporation by those in control. Finally he has the right to vote for directors and upon all propositions subject by law



to the control of the stockholders, and this is his supreme right and main protection. Stockholders have no direct voice in transacting the corporate business, but through their right to vote they can select those to whom the law intrusts the power of management and control.

A corporation is somewhat like a partnership, if one were possible, conducted wholly by agents where the copartners have the power to appoint the agents, but are not responsible for their acts. The power to manage its affairs resides in the directors, who are its agents, but the power to elect directors resides in the stockholders. This right to vote for directors and upon propositions to increase the stock or mortgage the assets, is about all the power the stockholder has. So long as the management is honest, within the corporate powers and involves no waste, the stockholders cannot interfere, even if the administration is feeble and unsatisfactory, but must correct such evils through their power to elect other directors. Hence, the power of the individual stockholder to vote in proportion to the number of his shares, is vital and cannot be cut off or curtailed by the action of all the other stockholders even with the co-operation of the directors and officers.

In the case before us the new stock came into existence through the exercise of a right belonging wholly to the stockholders. As the right to increase the stock belonged to them, the stock when increased belonged to them also, as it was issued for money and not for property or for some purpose other than the sale thereof for money. By the increase of stock the voting power of the plaintiff was reduced one-half, and while he consented to the increase he did not consent to the disposition of the new stock by a sale thereof to Blair & Company at less than its market value, nor by sale to any person in any way except by allotment to the stockholders. The increase and sale involved the transfer of rights belonging to the stockholders as part of their investment. The issue of new stock and the sale thereof to Blair & Company was not only a transfer to them of one-half the voting power of the old stockholders, but also of an equitable right to one-half the surplus which belonged to them. In other words, it was a partial division of the property of the old stockholders. The right to increase stock is not an asset of the corporation any more than the original stock when it was issued pursuant to subscription. The ownership of stock is in the nature of an inherent but indirect power to control the corporation. The stock when issued ready for delivery does not belong to the corporation in the way that it holds its real and personal property, with power to sell the same, but is held by it with no power of alienation in trust for the stockholders, who are the beneficial owners and become the legal owners upon paying therefor. The corporation has no rights hostile to those of the stockholders, but is the trustee for all including the minority. The new stock issued by the defendant under the permission of the statute did not belong to it, but was held by it the same as the original stock when first issued was held in trust

for the stockholders. It has the same voting power as the old, share for share. The stockholders decided to enlarge their holdings not by increasing the amount of each share, but by increasing the number of shares. The new stock belonged to the stockholders as an inherent right by virtue of their being stockholders, to be shared in proportion upon paying its par value or the value per share fixed by vote of a majority of the stockholders, or ascertained by a sale at public auction. While the corporation could not compel the plaintiff to take new shares at any price, since they were issued for money and not for property, it could not lawfully dispose of those shares without giving him a chance to get his proportion at the same price that outsiders got theirs. He had an inchoate right to one share of the new stock for each share owned by him of the old stock, provided he was ready to pay the price fixed by the stockholders. If so situated that he could not take it himself, he was entitled to sell the right to one who could, as is frequently done.

Even this gives an advantage to capital, but capital necessarily has some advantage. Of course, there is a distinction when the new stock is issued in payment for property, but that is not this case. The stock in question was issued to be sold for money and was sold for money only. A majority of the stockholders, as part of their power to increase the stock, may attach reasonable conditions to the disposition thereof, such as the requirement that every old stockholder electing to take new stock shall pay a fixed price therefor, not less than par, however, owing to the limitation of the statute. They may also provide for a sale in parcels or bulk at public auction, when every stockholder can bid the same as strangers. They cannot, however, dispose of it to strangers against the protest of any stockholder who insists that he has a right to his proportion. Otherwise the majority could deprive the minority of their proportionate power in the election of directors and of their proportionate right to share in the surplus, each of which is an inherent, pre-emptive and vested right of property. It is inviolable and can neither be taken away nor lessened without consent, or a waiver implying consent. The plaintiff had power, before the increase of stock, to vote on 221 shares of stock, out of a total of 5,000, at any meeting held by the stockholders for any purpose. By this action of the majority, taken against his will and protest, he now has only one-half the voting power that he had before, because the number of shares has been doubled while he still owns but 221. This touches him as a stockholder in such a way as to deprive him of a right of property. Blair & Company acquired virtual control, while he and the other stockholders lost it. We are not discussing equities, but legal rights, for this is an action at law, and the plaintiff was deprived of a strictly legal right. If the result gives him an advantage over other stockholders, it is because he stood upon his legal rights, while they did not. The question is what were his legal rights, not what his profit may be under the sale to Blair & Company, but what it might have been if the

new stock had been issued to him in proportion to his holding of the old. The other stockholders could give their property to Blair & Company, but they could not give his.

A share of stock is a share in the power to increase the stock, and belongs to the stockholders the same as the stock itself. When that power is exercised, the new stock belongs to the old stockholders in proportion to their holding of old stock, subject to compliance with the lawful terms upon which it is issued. When the new stock is issued in payment for property purchased by the corporation, the stockholders' right is merged in the purchase, and they have an advantage in the increase of the property of the corporation in proportion to the increase of stock. When the new stock is issued for money, while the stockholders may provide that it be sold at auction or fix the price at which it is to be sold, each stockholder is entitled to his proportion of the proceeds of the sale at auction, after he has had a right to bid at the sale, or to his proportion of the new stock at the price fixed by the stockholders.

We are thus led to lay down the rule that a stockholder has an inherent right to a proportionate share of new stock issued for money only and not to purchase property for the purposes of the corporation or to effect a consolidation, and while he can waive that right, he cannot be deprived of it without his consent except when the stock is issued at a fixed price not less than par and he is given the right to take at that price in proportion to his holding, or in some other equitable way that will enable him to protect his interest by acting on his own judgment and using his own resources. This rule is just to all and tends to prevent the tyranny of majorities which needs restraint, as well as virtual attempts to blackmail by small minorities which should be prevented.

The remaining question is whether the plaintiff waived his rights by failing to do what he ought to have done, or by doing something he ought not to have done. He demanded his share of the new stock at par, instead of at the price fixed by the stockholders, for the authorization to sell at \$450 a share was virtually fixing the price of the stock. He did more than this, however, for he not only voted against the proposition to sell to Blair & Company at \$450, but as the court expressly found, he "protested against the proposed sale of his proportionate share of the stock and again demanded the right to subscribe and pay for the same which demands were again refused," and "the resolution was carried notwithstanding such protest and demands." Thus he protested against the sale of his share before the price was fixed, for the same resolution fixed the price and directed the sale, which was promptly carried into effect. If he had not attended the meeting, called upon due notice to do precisely what was done perhaps he would have waived his rights, but he attended the meeting and before the price was fixed demanded the right to subscribe for 221 shares at par and offered to pay for the same immediately. It is true that



after the price was fixed he did not offer to take his share at that price, but he did not acquiesce in the sale of his proportion to Blair & Company, and unless he acquiesced the sale as to him was without right. He was under no obligation to put the corporation in default by making a demand. The ordinary doctrine of demand, tender and refusal has no application to this case. The plaintiff had made no contract. He had not promised to do anything. No duty of performance rested upon him. He had an absolute right to the new stock in proportion to his holding of the old and he gave notice that he wanted it. It was his property and could not be disposed of without his consent. He did not consent. He protested in due time, and the sale was made in defiance of his protest. While in connection with his protest he demanded the right to subscribe at par, that demand was entirely proper when made, because the price had not then been fixed. After the price was fixed it was the duty of the defendant to offer him his proportion at that price, for it had notice that he had not acquiesced in the proposed sale of his share, but wanted it himself. The directors were under the legal obligation to give him an opportunity to purchase at the price fixed before they could sell his property to a third party, even with the approval of a large majority of the stockholders. If he had remained silent and had made no request or protest he would have waived his rights, but after he had given notice that he wanted his part and had protested against the sale thereof, the defendant was bound to offer it to him at the price fixed by the stockholders. By selling to strangers without thus offering to sell to him, the defendant wrongfully deprived him of his property and is liable for such damages as he actually sustained.

The learned trial court, however, did not measure the damages according to law. The plaintiff was not entitled to the difference between the par value of the new stock and the market value thereof, for the stockholders had the right to fix the price at which the stock should be sold. They fixed the price at \$450 a share, and for the failure of the defendant to offer the plaintiff his share at that price we hold it liable in damages. His actual loss, therefore, is \$100 per share, or the difference between \$450, the price that he would have been obliged to pay had he been permitted to purchase, and the market value on the day of sale, which was \$550. This conclusion requires a reversal of the judgment rendered by the Appellate Division and a modification of that rendered by the trial court.

The order appealed from should be reversed and the judgment of the trial court modified by reducing the damages from the sum of \$99,450, with interest from January 30, 1902, to the sum of \$22,100, with interest from that date, and by striking out the extra allowance of costs, and as thus modified the judgment of the trial court is affirmed, without costs in this court or in the Appellate Division to either party.

HAGHT, J. (dissenting). I agree that the rule that we should adopt is that a stockholder in a corporation has an inherent right to purchase a proportionate share of new stock issued for money only, and not to

purchase property necessary for the purposes of the corporation or to effect a consolidation. While he can waive that right he cannot be deprived of it without his consent, except by sale at a fixed price at or above par, in which he may buy at that price in proportion to his holding or in some other equitable way that will enable him to protect his interest by acting on his own judgment and using his own resources. I, however, differ with Judge VANN as to his conclusions as to the rights of the plaintiff herein. Under the findings of the trial court the plaintiff demanded that his share of the new stock should be issued to him at par, or \$100 per share, instead of \$450 per share, the price offered by Blair & Company and the price fixed at the stockholders' meeting at which the new stock was authorized to be sold. This demand was made after the passage of the resolution authorizing the increase of the capital stock of the defendant company and before the passage of the resolution authorizing a sale of the new stock to Blair & Company at the price specified. After the passage of the second resolution he objected to the sale of his proportionate share of the new stock to Blair & Company and again demanded that it be issued to him, and the following day he made a legal tender for the amount of his portion of the new stock at \$100 per share. There is no finding of fact or evidence in the record showing that he was ever ready or willing to pay \$450 per share for the stock. He knew that Blair & Company represented Marshall Field and others at Chicago, great dry goods merchants, and that they had made a written offer to purchase the new stock of the company provided the stockholders would authorize an increase of its capital stock from five hundred thousand to a million dollars. He knew that the trustees of the company had called a special meeting of the stockholders for the purpose of considering the offer so made by Blair & Company. He knew that the increased capitalization proposed was for the purpose of enlarging the business of the company and bringing into its management the gentlemen referred to. There is no pretense that any of the stockholders would have voted for an increase of the capital stock otherwise than for the purpose of accepting the offer of Blair & Company. All were evidently desirous of interesting the gentlemen referred to in the company, and by securing their business and deposits increase the earnings of the company. This the trustees carefully considered, and in their notice calling the special meeting of the stockholders distinctly recommended the acceptance of the offer.

What, then, was the legal effect of the plaintiff's demand and tender? To my mind it was simply an attempt to make something out of his associates, to get for \$100 per share the stock which Blair & Company had offered to purchase for \$450 per share; and that it was the equivalent of a refusal to pay \$450 per share, and its effect is to waive his right to procure the stock by paying that amount. An acceptance of his offer would have been most unjust to the remaining stockholders. It would not only have deprived them of the additional sum of \$350

per share, which had been offered for the stock, but it would have defeated the object and purpose for which the meeting was called, for it was well understood that Blair & Company would not accept less than the whole issue of the new stock. But this is not all. It appears that prior to the offer of Blair & Company the stock of the company had never been sold above \$450 per share; that thereafter the stock rapidly advanced until the day of the completion of the sale on the 30th of January, when its market value was \$550 per share; but this, under the stipulation of facts, was caused by the rumor and subsequent announcement and consummation of the proposition for the increase of the stock and the sale of such increase to Blair & Company and their associates. It is now proposed to give the plaintiff as damages such increase in the market value of the stock, even though such value was based upon the understanding that Blair & Company were to become stockholders in the corporation, which the acceptance of plaintiff's offer would have prevented. This, to my mind, would not be done. I, therefore, favor an affirmance.

CULLEN, C. J., and WERNER and HISCOCK, JJ., concur with VANN, J. WILLARD BARTLETT, J., concurs with HAIGHT, J. O'BRIEN, J., absent.

Ordered accordingly.

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## IX. Preferred Stock <sup>14</sup>

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### STERNBERGH v. BROCK.

(Supreme Court of Pennsylvania, 1909. 225 Pa. 279, 74 Atl. 166, 24 L. R. A. [N. S.] 1078, 133 Am. St. Rep. 877.)

Bill by J. H. Sternbergh and others against Arthur Brock and others, directors, and H. M. Richards, treasurer of the American Iron & Steel Manufacturing Company, and such company. Decree for defendants, and plaintiffs appeal. Affirmed.

POTTER, J. On July 7, 1899, four manufacturing concerns, the Pennsylvania Bolt & Nut Company, J. H. Sternbergh & Son, the Lebanon Iron Company, and the East Lebanon Iron Company, entered into an agreement, by which they were to transfer to a proposed corporation the whole of their respective "plants, franchises, good will, business, patents, trade-marks, and property of every sort and kind." The agreement further provided that they should receive for the property so transferred full-paid and nonassessable preferred stock of the proposed corporation of the par value of \$50 per share, of which \$3,000,000 worth were to be issued, and divided among them in designated

<sup>14</sup> For discussion of principles, see Clark on Corp. (3d Ed.) §§ 142-145.



proportions. The agreement also provided: "The said preferred stock shall have an accumulative preference of five per cent. (5%) dividend annually, payable quarterly on the first days of January, April, July and October, and the first preference as to the distribution of the assets of the company; and further none of the property or franchises of the proposed company can be mortgaged without the consent of at least a majority of the preferred stock." Common stock to the extent of \$17,000,000 was also to be issued, divided into 340,000 shares, with a par value of \$50 each, upon which \$5 per share was to be paid in cash.

In pursuance of this agreement, the American Iron & Steel Company was incorporated on August 21, 1899, under the laws of Pennsylvania, for the manufacture of iron and steel products. The capital named in the articles of incorporation was 20 shares, with a par value of \$1,000, but this was increased by action of the stockholders on August 23, 1899, to \$20,000,000, divided in \$3,000,000 of preferred and \$17,000,000 of common stock, all of a par value of \$50 a share. By resolution adopted at the stockholders' meeting of August 23, 1899, it was provided "that the preferred stock whose issue was thereby authorized to the amount of \$3,000,000 should be entitled (a) 'to receive a cumulative yearly dividend of five per cent., payable quarterly on the first days of January, April, July, and October, in each year, before any dividends shall be set apart or paid on the common stock; (b) to be paid in full both principal and accrued dividends in the event of liquidation or dissolution of the company before any amount shall be paid to the holders of the common or general stock; (c) to require the consent in writing of a majority of the holders thereof to the creation of any mortgage.'" The stock was issued as provided for in the agreement and the resolution of the stockholders. On February 27, 1905, the common stock was reduced, after an assessment of \$2.50 a share had been levied, to 51,000 shares, of the par value of \$2,550,000, making the total capital stock \$5,550,000. From the organization of the company until the year 1907 the holders of preferred stock were paid the stipulated 5 per cent. annual dividend, and no more, while all profits above the amount so paid were distributed by dividends to the common stockholders. In March, 1907, a quarterly dividend of 2 per cent. was declared by the directors upon all the stock, both preferred and common, which was at the rate of 8 per cent. per annum.

J. H. Sternbergh, who was a holder of the common stock, filed this bill in equity against the directors and treasurer of the company and the corporation itself, alleging that the preferred stockholders were not entitled to receive more than 5 per cent. per annum on the par value of their stock, and praying the court to enjoin the payment to them of the dividend declared in excess of one-quarter of that amount. Answers and replication were filed, and the case was tried before Audenreid, J., who found that the plaintiffs were not entitled to an injunction and recommended that the bill be dismissed. Exceptions to

the findings of the trial judge were dismissed by the court in banc, and a decree made dismissing the bill, with costs. Plaintiffs have appealed, and have assigned for error the dismissal of their exceptions and the decree dismissing the bill.

Three questions are raised by the arguments of counsel on this appeal:

(1) Whether preferred stock issued by a company incorporated under the corporation act of 1874 is limited as to dividends to the amount of its preference; or whether, after payment of an equal amount as dividend on the common stock, it is entitled to participate in the distribution of the remaining profits, if any.

(2) Whether, under the agreement and resolution in the present case, the preferred stockholders can receive dividends of more than 5 per cent. per annum on the par value of their stock.

(3) Whether the alleged fact that for a long series of years the preferred stockholders were paid without objection on their part only 5 per cent. per annum and the entire balance of profits was paid to the common stockholders is to be considered in determining the present rights of the parties.

The authority to issue the preferred stock in the present case is derived from Act April 29, 1874 (P. L. 81) § 16, which provides: "Every corporation created under the provisions of this act, or accepting its provisions, may, with the consent of a majority in interest of its stockholders, obtained at a meeting to be called for that purpose, of which public notice shall be given during thirty days in a newspaper of the proper county, issue preferred stock of the corporation, the holders of which preferred stock shall be entitled to receive such dividends thereon as the board of directors of the corporation may prescribe, payable only out of the net earnings of the corporation." The learned judge of the trial court was of opinion that the present case is ruled by *Fidelity Trust Co. v. Lehigh Valley R. R. Co.*, 215 Pa. 610, 617, 64 Atl. 829, 832 (7 Ann. Cas. 613). It was there said: "When each class of stock had been paid 10 per cent., they were equal, and equally entitled to partake of whatever remained in the fund applicable for dividend purposes. The preferred stockholders were not creditors." In *West Chester, etc., R. R. Co. v. Jackson*, 77 Pa. 321, a loose expression was used when it was said that "preferred stock is only a form of mortgage." Whatever the extent of the preference in that case may have been, speaking generally, stock, whether it be common or preferred, does not represent indebtedness. Its possession means ownership of the company.

The authority under which the preferred stock was issued in *Fidelity Trust Co. v. Lehigh Valley R. R. Co.*, 215 Pa. 610, 64 Atl. 829, 7 Ann. Cas. 613, was contained in Act March 4, 1850 (P. L. 130), which provided: "And the said additional stock so issued shall be entitled to a preference over all the other stock of the said company in every future dividend of profits which may be declared by the said

company, until the holders of such additional stock shall have been paid from the funds applicable to the payment of such dividend, ten per cent. per annum on the amount of capital stock of the company represented by said shares of additional stock so held by them respectively; and the holders of the other stock of the company shall not be entitled to participate in any future dividend of the profits of the company until the holders of said additional stock shall have been paid from the funds applicable to such dividend, ten per cent. per annum on the amount of the capital stock of the company represented by said additional shares so held by them respectively." In reply to the same contention which is made here, the court below very appropriately, and as we think convincingly, said: "In attempting to distinguish between the contract in the present case and that considered by the Supreme Court in *Fidelity Trust Co. v. Lehigh Valley R. R. Co.*, much reliance is placed by counsel for the plaintiffs on three peculiarities of expression in the act of 1850. These are, first, the use of words alluding to the preferred stock thereby authorized as representing a definite part of the company's aggregate capital stock; second, the limitation of the preference by the words, 'until the holders of such additional stock shall have been paid 10 per cent. per annum'; and, third, the employment of the word 'participate' as applied to the right of the holders of the common stock to receive dividends from the company's profits. These points of difference are but trifling, and constitute no sound distinction between the essential terms of the two contracts under comparison. With respect to the use of the word 'participate,' it is enough to say that it probably refers here to the sharing of the profits of the corporation among the holders of the common shares themselves rather than to the distribution between the two classes of stockholders. The words which serve to limit the preference of the additional shares, viz., 'until the holders of such additional stock shall have been paid 10 per cent. per annum,' imply nothing different from what is implied by the words 'before any dividend shall be paid or set apart on the common stock' contained in clause 'a' of the resolutions of the American Iron & Steel Manufacturing Company, above quoted. The words 'amount of capital stock represented by said additional stock,' in the act of 1850, are devoid of the significance ascribed to them. They are merely a clumsy paraphrase of the expression 'par value' which the draftsman of the act probably regarded as too colloquial a term for use by the Legislature."

Where there is no stipulation in the contract to the contrary, the weight of authority clearly favors the right of preferred stockholders to share with the common stockholders in all profits distributed, after the latter have received an amount equal to the stipulated dividend on the preferred stock. "In the absence of special provisions, the holders of preferred stock in a corporation are in precisely the same position, both with respect to the corporation itself and with respect to creditors of the corporation, as the holders of common stock, except only



that they are entitled to receive dividends on their shares, to the extent guaranteed or agreed upon before any dividends can be paid to the holders of common stock." 2 Clark & Marshall on Priv. Corp. (1901) § 417c. "A share of stock is a share of stock, whether preferred or common." 1 Cook on Corps. § 269, note. See, also, 1 Elliott on Railroads (2d Ed.) § 84; 2 Beach on Priv. Corp. § 501. We do not find anything in the agreement or resolution in the present case which limited the preferred stockholders to a dividend of 5 per cent. per annum upon their stock.

With regard to the contention that the court should follow the construction placed upon the contract, which it is alleged the parties followed for a series of years—that is, by paying to the preferred stockholders only the stipulated 5 per cent. dividends, and awarding the remaining profits to the common stockholders—the trial judge does not find that any such construction was established, and he further finds that, except in the years 1905 and 1906, the dividends paid on the common stock were less than 5 per cent. of its par value. In discussing this feature he says: "Has there grown up any usage in the company at variance with the rights of the preferred stockholders as ascertainable from a fair reading of the resolutions under which the preferred shares were issued? The plaintiffs assert that there is such a custom, and, in support of their statement, point to the dividends paid on the common stock during the first 16 months of the company's existence, which aggregated \$1.25 per share on the common stock, a return of more than 18 per cent. per annum on the sum paid in on this stock, while during the same period the holders of preferred stock accepted without murmur dividends at the yearly rate of 5 per cent. on their shares. The effect of this evidence is entirely overcome, however, by the consideration that the dividends paid on the common stock yielded less than 2 per cent. on its par value. It is to be assumed that, before the holders of preferred stock could claim more than the 5 per cent. dividends that they received, the holders of the common stock were entitled to receive a dividend of the same percentage on the par value of their shares. To refuse them this right would be unjust. True it is that they had paid in only 10 per cent. of the amount of their subscriptions, and that the company had the use of but a comparatively small part of what they were obligated to pay in if called on, but the company enjoyed the credit of having such a resource as the unpaid subscriptions to its stock, and the common stockholders had at risk in the venture, not only what money they had paid in, but all for which they were still liable. It was proper, therefore, that the par value of their stock should be taken as the basis of their share in the company's profits, and, until they received more than 5 per cent. per annum on that basis (which they never did prior to 1905), the holders of preferred stock had no reason to complain." This conclusion commends itself to us.

With reference to this subject, the present Chief Justice in *Kane v. Insurance Co.*, 199 Pa. 205, 207, 48 Atl. 989, said: "Cotemporary construction of a contract by acts of the parties is entitled to very great weight, but it ought to appear with reasonable certainty that they were acts of both parties, done with knowledge, and in view of a purpose at least consistent with that to which they are now sought to be applied." In our view, these requirements are not met in the present case. Further, it should be noted that the rule invoked applies only to contracts that are ambiguous, and where the intention is doubtful. In 2 Page on Contracts (1905) § 1126, the rule is thus stated: "If a contract is ambiguous in meaning, the practical construction put upon it by the parties thereto is of great weight, even though the contract is in writing, and ordinarily is controlling. \* \* \* The practical interpretation of the parties is to be regarded, however, only when the contract is ambiguous. If clear and free from ambiguity, the intention shown upon its face, if written, must be followed, though contrary to the practical interpretation of the parties, and even if such practical construction has been acquiesced in for a long period of time."

We see no need in the present case for looking beyond the terms of the contract. We think it was properly construed by the court below. The assignments of error are overruled, and the decree is affirmed.

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## X. Watered and Bonus Stock<sup>15</sup>

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### CLARK v. BEVER.

(Supreme Court of United States, 1891. 139 U. S. 96, 11 Sup. Ct. 468, 35 L. Ed. 88.)

In 1872 the Burlington, Cedar Rapids & Minnesota Railway Company, being indebted to the Northern Construction Company in the sum of \$70,000, issued directly to the members of the latter company thirty-five hundred shares of its stock of the par value of \$100 per share, at twenty cents on the dollar; the stock being received in full satisfaction of the debt. The intestate Greene, at the time president of the Railway Company and a member of the Construction Company, received 910 shares as his portion of the stock so delivered. The evidence shows that the stock was without value; that the Construction Company was reluctant to take the stock and demanded cash. The good faith of all parties concerned is not questioned. What the original stockholders paid for their stock does not appear. At the time of this transfer the Railway Company was without means to pay

<sup>15</sup> For discussion of principles, see Clark on Corp. (3d Ed.) §§ 146-148.

its floating debt or the interest on the bonded debt. Its revenues were not sufficient to pay interest charges. In 1875 foreclosure proceedings were instituted, and in July, 1876, a sale of the property of the Railway Company under a decree of foreclosure was made to the Burlington, Cedar Rapids & Northern Railway Company.

Clark, the plaintiff below, was the holder of fifty gold bonds of the original company, secured by a mortgage on the net income and rolling stock of the company. In a suit on these bonds instituted in 1878, Clark obtained a judgment against the Railroad Company for \$65,517. A nulla bona return was made on an execution issued under this judgment in August, 1880.

The present action was commenced against the administrator of Greene to recover the eighty per cent. alleged to be due and unpaid on the stock received by Greene as in the settlement with the Construction Company. The case was subsequently removed upon petition of Clark to the Circuit Court of the United States for the District of Iowa and transferred by consent to the Eastern Division of the Southern District of that state. The trial court held as a matter of law that the intestate, Greene, by taking the stock did not become liable to pay anything further on account thereof to the creditors of the railroad company, and pursuant to direction the jury returned a verdict for the defendant.

HARLAN, J.<sup>16</sup> \* \* \* [After discussing the question of jurisdiction and the Iowa statutes, the court proceeds:]

Do the decisions of this court require us to hold, in such a case, that a creditor taking stock in payment of his claim is bound to other creditors for the face value of the stock? The plaintiff contends that our decisions are to that effect. Let us see. In *Sawyer v. Hoag*, 17 Wall. 610, 620, 21 L. Ed. 731, it was held that the capital stock of a corporation, especially its unpaid subscriptions, is a trust fund sub modo for the benefit of its general creditors. And this principle was reaffirmed in *Upton v. Tribilcock*, 91 U. S. 45, 23 L. Ed. 203; *Sanger v. Upton*, 91 U. S. 56, 23 L. Ed. 220; *Webster v. Upton*, 91 U. S. 65, 23 L. Ed. 384; *Pullman v. Upton*, 96 U. S. 328, 24 L. Ed. 818; *Chubb v. Upton*, 95 U. S. 665, 24 L. Ed. 523; *Morgan Co. v. Allen*, 103 U. S. 498, 26 L. Ed. 498; *Scovill v. Thayer*, 105 U. S. 143, 26 L. Ed. 968; *Hawkins v. Glenn*, 131 U. S. 319, 335, 9 Sup. Ct. 739, 33 L. Ed. 184, and *Richardson v. Green*, 133 U. S. 30, 45, 10 Sup. Ct. 280, 33 L. Ed. 516. There is no dispute here as to the soundness of this general principle. The dispute is as to its application to a case like the present one. We can be aided in solving this inquiry by ascertaining the character of the particular cases in which it has been applied by this court.

In *Sawyer v. Hoag*, a subscription of \$5,000 to the stock of an insurance company for which the subscriber paid in full, but received

<sup>16</sup> Statement rewritten and portions of the opinion are omitted.



in return the check of the corporation for \$4,250 under an agreement that the debt for the stock should be extinguished, and the amount of the check should be treated simply as a loan of money to the stockholder, was held to be a mere device to evade the rule that unpaid subscriptions of stock constitute a trust fund for the benefit of the creditors of the corporation; consequently, that the stock there in question was to be regarded, as between the corporation and creditors, to be unpaid to the extent of the amount received back from the corporation under the pretense of a loan. In *Upton v. Tribilcock*, an actual subscriber to the stock of an insurance company upon which he agreed to pay 20 per cent., was held responsible for the balance, and could not escape liability therefor, because of representations by the agent, at the time of the subscription, that he would be only responsible for that amount, or by proving a subsequent arrangement with the company canceling the subscription and accepting, as in full payment, his note for the 20 per cent. agreed to be paid. *Sanger v. Upton* was another case of the actual subscription of stock upon which the subscriber was held to pay the full sum subscribed. In *Webster v. Upton* a person holding certificates of stock by transfer from the original subscriber, and standing upon the books of the corporation as a stockholder, was held liable for the balance due upon the stock, without proof of an "express" promise upon his part to pay. In *Chubb v. Upton* the decision was that one receiving a certificate of stock for a certain number of shares, at a given sum per share, thereby became liable to pay the amount thereof when called upon by the corporation or its assignee in bankruptcy; and in *Pullman v. Upton*, that a transferee of stock who caused the transfer to be made to himself, as collateral security for a debt of the transferrer, was liable for the balance due on such stock. The doctrine of the latter case was approved in *Hawkins v. Glenn*. In *Morgan Co. v. Allen* it was decided that the subscription by a company to the capital stock of a railroad company, together with the bonds given therefor, constituted with other property of the company a trust fund, to which all its creditors could rightfully look for satisfaction of their claims; and that by no device or combination, to which particular creditors were parties, could it withdraw its bonds from that fund, and thereby avoid liability to the general creditors of the company. In *Scovill v. Thayer* it was declared, among other things, that a contract between a corporation and its stockholders, that they should never be called upon to pay any other assessment than that paid at the outset, while good as between the corporation and the stockholders, was a fraud in law upon creditors, which they could have set aside whenever their rights intervened and their claims were unsatisfied. In *Richardson v. Green* it was held that the issuing by a corporation of bonus stock was in violation of a statute of the state declaring it to be unlawful to issue certificates of stock until the shares were fully paid, and that one exercising the privileges and powers of a stockholder in

a corporation was not exempt from the liabilities attaching to a bona fide stockholder who took shares purporting to be, but which in fact were not, fully paid.

This detailed statement of the above cases has been made because of the confident assertion that they rest upon doctrines necessarily requiring the reversal of the judgment. We do not concur in this view. In all of these cases, except one, there was an actual subscription of a given amount. They were cases of promises to pay the company the amount subscribed, not of sales by it. According to those cases, a stockholder, becoming such by formal subscription or by transfer upon the books of the corporation, cannot be discharged to the injury of creditors by any agreement, arrangement, or device to which creditors do not give their assent, and by which the stockholder is to pay less than the amount due upon such stock; this, upon the ground stated in *Webster v. Upton*, that "neither the stockholders nor their agents, the directors, can rightfully withhold any portion of the stock from the reach of those who have lawful claims against the company," and that "the stock thus held in trust is the whole stock, not merely that percentage of it which has been called in and paid." The present case presents features that are not to be found in the others. It is not the case of an ordinary subscription of stock in a given amount. Nor is it, strictly, one of an ordinary purchase of stock for purposes of investment. It is the case of a creditor of an insolvent railroad corporation which, in consequence of its inability to pay creditors in money, was threatened with bankruptcy, and which refused or was unable to pay except in stock that was without market value. To say that a public corporation, charged with public duties, may not relieve itself from embarrassment by paying its debt in stock at its real value—there being no statute forbidding such a transaction—without subjecting the creditor, surrendering his debt, to the liability attaching to stockholders who have agreed, expressly or impliedly, to pay the face value of stock subscribed by them, is, in effect, to compel them either to suspend operations the moment they become unable to pay their current debts, or to borrow money secured by mortgage upon the corporate property. We do not think the statute of Iowa can be properly construed to cause such a result in respect to corporations organized under its laws.

We must not be understood as modifying in any respect the principles laid down in the cases above cited, nor the salutary rule laid down in *Sawyer v. Hoag*, that when the interest of the public or of strangers is to be affected by any transaction between the stockholders owning the corporation and the corporation itself, "such transaction should be subject to a rigid scrutiny, and, if found to be infected with anything unfair towards such third person calculated to injure him, or designed intentionally and inequitably to screen the stockholder from loss at the expense of the general creditor, it should be disre-

garded or annulled so far as it may inequitably affect him." These principles were reaffirmed in *Richardson v. Green*, and should not be relaxed in any case in which they may be applied consistently with justice. So, when the interest of creditors require, those who hold shares of stock in a corporation, purporting to be, but which are shown not to have been, paid for to the extent of their face value, should be held liable to pay for such shares in full, unless it appears that they acquired the stock under circumstances that did not give creditors and other stockholders just ground for complaint. As said by this court in *Peters v. Bain*, 133 U. S. 670, 691, 10 Sup. Ct. 354, 361, 33 L. Ed. 696, "unpaid subscriptions to stocks are assets, and have frequently been treated by courts of equity as if impressed with a trust sub modo, in the sense that neither the stockholders nor the corporations can misappropriate such subscriptions so far as creditors are concerned." See, also, *Graham v. Railroad Co.*, 102 U. S. 148, 161, 26 L. Ed. 106; *Railroad Co. v. Ham*, 114 U. S. 587, 594, 5 Sup. Ct. 1081, 29 L. Ed. 235; *Fogg v. Blair*, 133 U. S. 534, 541, 10 Sup. Ct. 338, 33 L. Ed. 721. \* \* \*

The judgment below, in our opinion, is in accordance with the law as it was adjudged to be when Greene received the stock in question and surrendered his claim upon the railroad company, and with the law as this court has since that time frequently declared it to be; and our duty is to so declare in the case before us. Judgment affirmed.

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### SOUTHWORTH v. MORGAN.

(Court of Appeals of New York, 1912. 205 N. Y. 293, 98 N. E. 490, 51 L. R. A. [N. S.] 56.)

COLLIN, J.<sup>17</sup> The plaintiff, trustee of the bankrupt corporation, Remington Automobile & Motor Company, seeks to recover from the defendant a sum unpaid, upon a subscription by the defendant for two shares of the capital stock of the corporation.

The trial court found as facts: The bankrupt was organized in 1900 under the laws of New Jersey. Its authorized capital stock was \$250,000, divided into 2,500 shares of the par value of \$100 each. Soon after its incorporation, the board of directors adopted a resolution as follows: "Resolved, that for the purpose of securing a local interest in the Remington Automobile & Motor Company on the part of the citizens of Ilion (N. Y.) that 200 shares of the stock be issued, to be sold at \$25 per share, and that the proceeds of such sale be placed in the treasury, to be used for regular expenses." Thereafter, in pursuance of the resolution, the general manager and secretary of the corporation presented to the defendant a writing, which contained the agreements that the plant of the corporation was to be located and its

<sup>17</sup> Portions of the opinion are omitted.



business to be carried on at Ilion, and that the defendant would purchase two nonassessable shares of the capital stock of the corporation at \$25 for each share and no more would ever have to be paid upon them. The defendant signed the agreement and purchased the two shares of stock upon the distinct understanding and agreement made between the defendant and the general manager and secretary of the corporation that \$25 per share fully paid for the stock. He paid \$50 for the two shares of stock at the time he received them. The corporation located its plant at Utica, N. Y., and not at Ilion. In December, 1902, the company was adjudged a bankrupt, and in April, 1906, the United States District Court granted an order directing a call or assessment upon the defendant and others of \$75 per share to meet the deficiency in the assets of said corporation to meet the obligations of its creditors, said assessments to be paid on or before July 1, 1906, and the defendant was duly served with a copy of said order. The court found as a conclusion of law that the plaintiff was entitled to recover the sum of \$150, a conclusion which the facts found do not support.

The liability of the defendant is to be determined by the law of the state of New Jersey. That state, through its laws, gave the corporation its existence, powers, liabilities, and the limits within which it was free to act, and a citizen of this state, who became a shareholder in it, entered into contract relations, the extent and obligation of which depended upon the laws, in so far as they do not violate a statute or the settled public policy of this state. *Lowry v. Inman*, 46 N. Y. 119; *Hancock National Bank v. Ellis*, 166 Mass. 414, 44 N. E. 349, 55 Am. St. Rep. 414; *Molson's Bank v. Boardman*, 47 Hun, 135.

The relevant laws of New Jersey are not disclosed or laid before us by the printed record; nor do the findings make known the provisions of the charter of the bankrupt other than that stated relating to the authorized capital stock. We are confined to the case as the record presents it. The laws of other states are facts which must be alleged and proved and of which we cannot take judicial notice either in their language or their interpretation. *Genet v. Del. & Hud. Canal Co.*, 163 N. Y. 173, 177, 57 N. E. 297; *Hancock National Bank v. Ellis*, 166 Mass. 414, 44 N. E. 349, 55 Am. St. Rep. 414.

In the absence of those facts, we must presume that the common law of New Jersey is the same as the common law of New York. *Ruse v. Mut. Benefit Life Ins. Co.*, 23 N. Y. 516, 522.

It is urged by the respondent, at this point, that the order of the United States District Court directing the assessment of the shares of the defendant conclusively determined the validity and the amount of the assessment. It is true that the regularity and validity of the proceeding in that court and its conclusions cannot be attacked in this action; but the existence or nonexistence of an obligation on the part of the defendant to pay the assessment was not within the subject-matter of which that court took jurisdiction. To enable the plaintiff

to enforce the liability of the delinquent shareholders to the extent only which the deficiency in the corporate assets required and to effect parity of contribution between them, it was necessary that an account of the assets and debts, of the entire amount of the capital remaining unpaid upon the issued shares, and the part of the face value of his shares unpaid by each stockholder, should be taken, and the aggregate assessment required equitably rated by the court, and it is upon those issues that its order is beyond attack in this action. *Great Western Telegraph Co. v. Purdy*, 162 U. S. 329, 16 Sup. Ct. 810, 40 L. Ed. 986; *Howarth v. Angle*, 162 N. Y. 179, 56 N. E. 489, 47 L. R. A. 725. \* \* \* The respondent does not contend that the charter provision dividing the authorized capital stock into shares "of the par value of \$100 each" prohibited the creation of an actual share or interest upon a consideration less than \$100, or secured to the creditors or their representative the right of collecting upon each share, as the discharge of the corporate debts demands, the difference between the consideration and \$100.

Inasmuch as no statute of the state of New Jersey, nor provision of the charter of the corporation relative to the liability of the defendant, was proven, we turn to the common law, remarking parenthetically, however, that we have not been referred to and have not found any domestic statute which prescribes, as a condition to the exercise here of the rights derived from the state of New Jersey that the shareholders shall be liable to the creditors or their representative up to the nominal value of their stock, and there is therefore no statutory, as there is no charter, prohibition against the issuance of the shares of the capital stock for less than their par value as named in the charter, and no statutory mandate that the shares shall be deemed issued and held subject to the payment of such value. Nor do the principles of the common law of this state work such results. In *Christensen v. Eno*, 106 N. Y. 97, 102, 12 N. E. 648, 650, 60 Am. Rep. 429, the action was brought by a judgment creditor of an insolvent corporation organized under the laws of Illinois to recover 40 per cent. of the authorized par value of \$100 each of 25 shares of the stock of the company issued to but unsubscribed for by the defendant, upon which the 40 per cent. was not paid, but, as a gratuity, was credited as paid, when the stock was issued. Judge Andrews, writing for this court, which reversed the judgment in favor of the plaintiff, said (citing authorities): "But the liability of a shareholder to pay for stock does not arise out of his relation, but depends upon his contract, express or implied, or upon some statute, and in the absence of either of these grounds of liability, we do not perceive how a person to whom shares have been issued as a gratuity has, by accepting them, committed any wrong upon creditors, or made himself liable to pay the nominal face of the shares as upon a subscription or contract." The principles which determined our judgment in that case were reaffirmed in *Christensen v. Colby*, 110 N. Y. 660, 18 N. E. 480.

In the case at bar, no statute supports the alleged liability of the defendant, and the express agreement between the corporation and the defendant was that the defendant should pay 25 per cent. of the nominal value of the shares and no more. The respondent contends, however, and therein he has been successful in the courts below, that the creditors of the corporation represented by the plaintiff have the right to compel the payment of the unpaid 75 per cent. because the capital stock is a trust fund for the security of the creditors, and that a liability in their favor to the extent of the unpaid part of the nominal value of the actual shares exists and can be enforced. Such contention availed the plaintiff in the Christensen case until it reached this court, the General Term saying therein that the practical effect of the transaction was to take out of the assets, to which the creditors were entitled, the 40 per cent. indorsed as paid upon the stock, when in fact it was not paid. It is strenuously urged that this case is not controlled by the principles which decided the Christensen case, for the reason that the defendant subscribed for the two shares of the capital stock, while in the Christensen case the stock certificate was merely issued to and accepted by the defendant. The subscription, as expressed in the agreement between the defendant and the corporation, has been completely fulfilled by the payment in full of the sum it bound him to contribute and therewith his liability to the corporation or the creditors terminated, unless there issued from the trust fund doctrine, through implication, a contract which, in the paramountcy given it by the fact that it was the irresistible product of the law, nullified the expressed stipulation that \$25 was the whole sum to be paid upon each share, and substituted in its place the requirement that, as to the creditors, there should be paid \$100, or so much thereof as the satisfaction of their demands made necessary. The doctrine has not such potency. Its peculiar vigor is that, contrary to the common law of England, it secures to the creditors of insolvent corporations or their representatives the right of enforcing subscriptions for shares of which the corporation has deprived itself by release or defeasance. It declares that the capital stock of a corporation is a substitute for the personal liability which subsists in individual or partnership undertakings, and is a fund set apart as a security for the payment of the corporate debts. The capital or capital stock which it thus segregates is not the capital stock authorized or named in the charter of the corporation. If it were, the members would be bound by the doctrine to contribute on account of it the sum within its named value needed to pay the debts of the insolvent corporation. The statement in the charter does not create a security for the creditors. It creates authorized or potential capital stock and shares which, transferred into actual shares through the acquisition of subscribing members and their payments, produces the money or property which, put into a single corporate fund, is the actual capital or capital stock on which the business is undertaken and the assets or fund contemplated by the trust fund doctrine which the directors or



stockholders may not lawfully diminish by appropriating or squandering it or giving it away. And as there is not a fund or security in the nominal or potential shares, there is none in the excess of the nominal value over the subscribed value of the shares. The subscription agreements, as they are enforceable through their express provisions or implications or statutory conditions, are the sources and the measure of the duty of the subscribers. *Christensen v. Eno*, 106 N. Y. 97, 12 N. E. 648, 60 Am. Rep. 429; *Burrall v. Bushwick Railroad Co.*, 75 N. Y. 211. The doctrine further declares that unpaid subscriptions are a part of the capital and that a subscriber cannot be discharged to the injury of creditors by arrangement or device to which creditors do not give their assent and by which he is to pay less than his subscription. *Stoddard v. Lum*, 159 N. Y. 265, 53 N. E. 1108, 45 L. R. A. 551, 70 Am. St. Rep. 541; *Ward v. City Trust Co.*, 192 N. Y. 61, 84 N. E. 585; *Hazard v. Wight*, 201 N. Y. 399, 94 N. E. 855. The doctrine does not create or nullify subscriptions. It lays hold of the assets of an insolvent corporation, and in doing that it compels subscribers to fulfill their legal obligations and perform their legal duties; but it does not beget those duties or obligations; it does not make unlawful or invalid a subscription which, apart from it, was valid and lawful. The question with it is: Has the subscriber fully performed the subscription agreement as it in fact and in law exists? And an affirmative finding renders it inapplicable and inoperative. In the case at bar there were no statutory conditions upon which the shares might be owned. The agreement between the defendant and the corporation expressed with completeness the obligations and liability of the defendant for his shares. He has fulfilled the obligation and thereby destroyed the liability. The trust fund doctrine is inapplicable, and the findings of fact do not constitute a cause of action. \* \* \*

The judgment should be reversed, and a new trial granted; costs to abide the event.

HAIGHT, VANN, WILLARD BARTLETT, HISCOCK and CHASE, JJ., concur.

CULLEN, C. J. I concur on the sole ground that, as shown in the opinion of COLLIN, J., the question involved in the appeal is settled by the authority of the previous decisions of this court. Were it an original one, I should reach a contrary conclusion.

## XI. Actions by Stockholders for Injuries to Corporation—Interference in Management <sup>18</sup>

### WATHEN v. JACKSON OIL & REFINING COMPANY.

(Supreme Court of United States, 1915. 235 U. S. 635, 35 Sup. Ct. 225, 59 L. Ed. 395.)

Appeal from the District Court of the United States for the Southern District of Mississippi to review an order denying a preliminary injunction in a suit by a stockholder to restrain the corporation from complying with, and certain public officers from enforcing, a state statute which he asserts is unconstitutional. Affirmed.

Mr. JUSTICE HUGHES delivered the opinion of the court:

The appellant brought this suit in the district court to restrain the Jackson Oil & Refining Company, its manager and officers, from complying with a statute of Mississippi prohibiting employment in described occupations for more than ten hours a day, except in cases of emergency or public necessity (chapter 157, Laws of Mississippi, 1912, p. 165), and to enjoin the other defendants (certain public officers) from enforcing its provisions as against that company.

It was alleged in the bill, in substance, that the defendant corporation was engaged in operating a cotton-seed oil mill of the value of \$100,000; that the complainant owned 502 shares of its stock of the par value of \$100 each, and of the actual value of \$60,000; that the business required that the mill should be operated continuously, both day and night, two shifts of laborers being employed; that the employment was under wholesome conditions, without any detriment to the physical, mental, and moral well-being of those employed; that the statute, if enforced, would work a deprivation of liberty of contract and of property, and an arbitrary discrimination, contrary to the Fourteenth Amendment; that compliance with the statute would involve greatly increased cost of operation and render the corporation insolvent and its property valueless, to the complainant's injury; that the statute had been sustained by the supreme court of Mississippi in a suit against another manufacturing company; that, although the officers of the defendant corporation desired to disobey the statute, they were complying therewith, being constrained to obedience through fear of the enormous penalties imposed; and that these penalties were so severe that no owner or operator in the position of the defendant corporation could invoke the jurisdiction of a court to test the validity of the statute, except at the risk of confiscation.

Those defendants who were public officers demurred to the bill upon

<sup>18</sup> For discussion of principles, see Clark on Corp. (3d Ed.) §§ 149-151.

the grounds (among others) that the complainant, as a stockholder of the corporation, had no right to sue; that the bill could not be maintained to restrain the enforcement of the criminal law of the state; and that the statute was constitutional.

An application for a preliminary injunction was heard on the bill and demurrer and was denied, and from the order entered to this effect the complainant appeals to this court. Judicial Code, § 266 (36 Stat. at L. 1162, chap. 231, Comp. Stat. 1913, § 1243).

The objection urged below, and repeated here, that the complainant has failed to show any right to maintain this suit, must be sustained. The right of action to restrain the enforcement of the statute as an unconstitutional deprivation of the liberty and property of the corporation was a right existing in the corporation itself, and a stockholder was not entitled to sue without showing to the satisfaction of the court that he had exhausted the means within his reach to obtain action by the corporation in conformity with his wishes. *Hawes v. Oakland* (*Hawes v. Contra Costa Water Co.*) 104 U. S. 450, 460, 461, 26 L. Ed. 827, 832; *Detroit v. Dean*, 106 U. S. 537, 541, 542, 27 L. Ed. 300, 302, 1 Sup. Ct. 500; *Quincy v. Steel*, 120 U. S. 241, 248, 30 L. Ed. 624, 626, 7 Sup. Ct. 520; *Doctor v. Harrington*, 196 U. S. 579, 588, 49 L. Ed. 606, 610, 25 Sup. Ct. 355. The former equity rule (rule 94) provided not only that the bill must allege that the suit was "not a collusive one to confer upon a court of the United States jurisdiction of a case of which it would not otherwise have cognizance," but that the bill "must also set forth with particularity the efforts of the plaintiff to secure such action as he desires on the part of the managing directors or trustees, and, if necessary, of the share holders, and the cause of his failure to obtain such action." The present rule (rule 27) adds to this provision the words,— "or the reasons for not making such effort;" and these reasons, of course, must be adequate. The rule embraces those cases where the wrong to the corporation arises from unconstitutional legislation. *Corbus v. Alaska Treadwell Gold Min. Co.*, 187 U. S. 455, 47 L. Ed. 256, 23 Sup. Ct. 157; *Davis & F. Mfg. Co. v. Los Angeles*, 189 U. S. 207, 220, 47 L. Ed. 778, 781, 23 Sup. Ct. 498; *Ex parte Young*, 209 U. S. 123, 143, 52 L. Ed. 714, 722, 13 L. R. A. (N. S.) 932, 28 Sup. Ct. 441, 14 Ann. Cas. 764. Here, while it is averred that the suit is not a collusive one in order to confer a jurisdiction which would not otherwise exist, there is no allegation that the complainant has made any request that the corporation should bring the suit to prevent the alleged invasion of its rights; nor does it appear that, by reason of antagonistic control of the corporation, such a request would be futile. Although apparently the holder of a majority of its stock, the complainant does not show any effort whatever to induce the corporation to sue. He contents himself with asserting in effect that, though the directors and officers do not wish to comply with the statute, they will do so through fear of its penalties. But this reason is palpably inadequate, inasmuch as the corporation itself would be en-



titled to protection against the imposition of such penalties as would virtually deny access to the courts for the protection of rights guaranteed by the Federal Constitution. *Ex parte Young*, 209 U. S. 147, 52 L. Ed. 723, 13 L. R. A. (N. S.) 932, 28 Sup. Ct. 441, 14 Ann. Cas. 764; *Willcox v. Consolidated Gas Co.*, 212 U. S. 53, 54, 53 L. Ed. 400, 48 L. R. A. (N. S.) 1134, 29 Sup. Ct. 192, 15 Ann. Cas. 1034; *Missouri P. R. Co. v. Tucker*, 230 U. S. 340, 351, 57 L. Ed. 1507, 1511, 33 Sup. Ct. 961; *Ohio Tax Cases*, 232 U. S. 576, 587, 58 L. Ed. 738, 743, 34 Sup. Ct. 372; *Wadley Southern R. Co. v. Georgia* (decided this day) 235 U. S. 651, 59 L. Ed. 405, 35 Sup. Ct. 214. The allegations of the bill show no ground for dispensing with efforts to procure action by the corporation; and in this view, without discussing the merits of the case, we are of the opinion that the complainant was not entitled to the injunction sought.

Order affirmed.

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### BARTLETT v. NEW YORK, N. H. & H. R. CO.

(Supreme Judicial Court of Massachusetts, 1915. 221 Mass. 530, 109 N. E. 452.)

Suit by Ralph S. Bartlett and others against the New York, New Haven & Hartford Railroad Company and others. Case reserved for the full court on demurrers to the bill. Demurrers sustained.

RUGE, C. J. This is a suit in equity brought by certain stockholders in the defendant corporation, in behalf of themselves and all other stockholders who desire to join, to enforce liabilities which are alleged to have accrued in its favor against some of its present and former directors. The defendants are the New York, New Haven & Hartford Railroad Company, hereafter referred to as the corporation, certain individuals who either now are or have been directors of the corporation, and the personal representatives of certain deceased directors. The grounds upon which this liability is alleged to rest are negligence of the directors of the corporation in its management, whereby purchases of street railway companies, steamboat lines and railroads at prices vastly in excess of their real value have been made with the moneys of the defendant corporation, and the investment of large sums in ventures ultra vires the defendant corporation, and the establishment of a monopoly in contravention of the Sherman Anti-Trust Act (Act Cong. July 2, 1890, c. 647, 26 Stat. 209), all through the misconduct of these directors, to the great loss of the corporation.

A stockholder of a corporation has no personal right of action against directors who have defrauded it and thus affected the value of his stock. Such wrongs are against the corporation itself and, except through that, have no relation to the stockholder. It is the corporation alone whose interests are directly concerned, whose rights are to be asserted, and to whose exclusive use the judgment, if recovered, must be paid. *Converse v. United Shoe Mach. Co.*, 185 Mass. 422, 70

N. E. 444; *Id.*, 209 Mass. 539, 95 N. E. 929. The averments of the first paragraph of the bill, while not specific in this respect, when read in conjunction with other averments and especially with the fourth prayer, are that the plaintiffs bring the bill entirely for the benefit of the corporation and not in their own interest except as indirectly they may profit by having money wrongfully taken from it restored to the corporation.

Demurrers have been filed founded on the omission of the plaintiffs to aver that the directors have failed to act after a reasonable demand made upon them to act, or that such demand would have been useless.

A stockholder, before he can proceed in his own name but in its behalf for the redress of wrongs done to the corporation, must establish that he has exhausted all available means to obtain relief through the corporation itself, unless the circumstances excuse him from so doing. That is a condition precedent. Facts showing that he has complied with this condition must be set forth in unmistakable terms in his bill. He must make an earnest and sincere and not a feigned or simulated effort to induce the managing officers of the corporation to take remedial action in its name. If he fails in this quarter, unless there is adequate reason to the contrary, he must resort to the stockholders and make an honest attempt to convince them that action ought to be instituted. Directors and the majority of stockholders are presumed to be acting, not fraudulently, but with fair discretion in obedience to law, and in good faith toward all concerned, and with a consciousness of duty toward the corporation and all its stockholders. It is an implied condition of becoming a stockholder in a corporation that its general policy shall be determined by the holders of a majority of the stock and that disagreements as to its dominating policy and as to the details of its management shall be settled by the stockholders, and that recourse cannot be had to the courts to adjust difficulties of this sort. It is only from actual necessity, in order to prevent a failure of justice, that a suit in equity for the benefit of the corporation can be maintained by a stockholder. As was said in *Dunphy v. Travelers' Newspaper Ass'n*, 146 Mass. 495, at pages 496, 497, 16 N. E. 426, at page 430: "Courts of equity are swift to protect helpless minorities of stockholders of corporations from the oppression and fraud of majorities. But the legal relations into which the members of a corporation enter require them to seek redress for supposed wrongs done them as stockholders from its officers, and from the corporation itself, before applying elsewhere." *Hawes v. Oakland*, 104 U. S. 450, 26 L. Ed. 827; *Wathen v. Jackson Oil Co.*, 235 U. S. 635, 639, 35 Sup. Ct. 225, 59 L. Ed. 395.

The same principle is applied to unincorporated organizations and beneficiary corporations. *Hickey v. Baine*, 195 Mass. 446, 81 N. E. 201; *Correia v. Portuguese Fraternity*, 218 Mass. 305, 309, 105 N. E. 977.

The allegations of the bill upon this point are that the plaintiffs have caused to be sent to each of the directors now in office a letter touching some of the wrongs complained of and asking for notice of their decision respecting it. It is alleged that there are 23 directors, 2 living in Pennsylvania, 1 in Rhode Island, 3 in New York, 4 in different parts of Massachusetts, and 13 in various cities and towns in Connecticut. The letter was mailed in Boston on Friday, July 10, 1914. The bill was filed in court a week later, on Friday, July 17, 1914. Although it is not alleged how the letter was directed, the most that can be assumed is that it reached each of the directors on the following day, Saturday. Only five business days thereafter intervened before the bill was filed. It requires no discussion to show that such notice and request, even if sufficient in form, was entirely too short in time for any practical purpose. A meeting of a board so large, composed of members whose residences are so widely separated as these, hardly could have been held, unless previously called, much, if any before the suit was brought. The magnitude of the claims made, the length of time during which it is alleged that the wrongs to the corporation were perpetrated, and the intricacy of the separate transactions and the subterfuges resorted to by the guilty directors in their efforts to conceal the true nature of their conduct, all as set forth in the bill, manifestly rendered it impossible for any board of directors, however honest and alert, to make even a superficial examination of the matters set forth in the letter. The letter in direct words suggests an investigation as to "suspicious circumstances" which "may disclose proof of fraudulent participation by directors in secret and illegal profits, or other forms of fraudulent maladministration." By fair implication it suggests other investigations, which even with the utmost expedition could not have been completed except after the lapse of some time. Moreover, the letter invites from the directors "notice of your decision as to compliance" with the letter. A bald acknowledgment of the receipt of such a letter scarcely could have been reasonably expected—certainly no notice of collective decision as to a course of action to be pursued regarding its subject matter—before the suit actually was instituted. The bill does not allege that no action was taken by the directors in response to the letter, nor that no answer was received by the writers. It is quite consistent with all its allegations that a meeting of the directors was held, notwithstanding the shortness of time, at which the letter was referred to competent counsel and notice thereof sent to the writers of the letter. An affidavit pretty nearly to that effect, printed in the record, is not attached to or referred to in the bill, was filed later, and hence cannot be treated as rightly before us; but the existence of such facts are not at all incompatible with the bill. It is not necessary to consider whether the letter contained sufficient information and was a demand adequate in form to be the basis of an individual suit by a stockholder. Making all assumptions in its fa-



vor, it is too plain for further discussion that the plaintiffs do not allege any facts which show that they have made a genuine and substantial effort to induce action by the directors with a real purpose to bring about that result before filing their bill. There is no ground for the argument that the bill shows reason for haste. The record is bare of any facts indicating that the rights of the plaintiffs or of the corporation would have been adversely affected by waiting a reasonable time to afford the directors opportunity either to institute proceedings or to refuse to do so. The statement of the bill that "the plaintiffs aver upon belief that the present board of directors will not cause the defendant corporation to institute action against some of their own members, or cause proceedings to be prosecuted as the interests of the corporation itself require," is an unavailing allegation unless supported by facts showing adequate foundation for such belief. There are no such facts set out in this bill.

There is no allegation of any attempt to bring the wrongs of which complaint is made to the attention of the stockholders.

A bill may be maintained by a stockholder in behalf of the corporation to redress wrongs done to it without making any demand upon the directors or upon the stockholders to cause the corporation itself to institute proceedings, provided it appears by appropriate allegations that that would have been an idle ceremony. The law in this regard is settled. The allegations of the bill must be certain and unmistakable in setting forth facts which show that it would have been useless to ask the directors or the corporation to act. Generalities unaccompanied by specific and definite facts are not enough. The sufficiency of the present bill in this regard best may be tested by comparison with the leading case, *Brewer v. Boston Theatre*, 104 Mass. 378, a case similar in all essential respects. That was a bill in equity by minority stockholders brought to recover for frauds perpetrated by directors against the corporation. It was alleged that three of the directors, who were defendants, were still members of the board of directors which consisted of seven, and "that a majority of the present board of directors of said defendant corporation are acting in the interests of and are under the control of" the two former directors responsible for the frauds, and further, that the present directors "have allowed themselves to be little else than the creatures" of the corrupt directors "and the registers of their wishes, and have come to consider that no duty rested or now rests upon them as directors to do more or other than to make said corporation, and the property of the plaintiffs therein invested, serviceable to" the corrupt directors. This statement of facts was accompanied by allegations of "undue influence, corruption, negligence, fear and fraud" exercised by the guilty directors during the period of their unlawful transactions. It was held that these allegations were not sufficient for the reason that the defendant directors were a minority of the board as

then constituted, and that it did not appear that the majority were "willfully disregarding of the interests of the corporation" and that the allegations were not equivalent to "a request and refusal of the use of the corporate name and authority for the redress of the wrongs complained of," nor do they "show that such an application, upon a suitable representation of the facts, would be unavailing." 104 Mass. 388. After the first decision in *Brewer v. Boston Theatre*, from which quotations have been made, the bill in that case was amended to the extent of averring that the majority of the board of directors were fully cognizant of all the breaches of trust and frauds committed by the faithless directors upon the corporation and openly excused and justified the same, and had been and "are now knowingly, willfully and fraudulently \* \* \* in collusion with" such faithless directors "in seeking to secure and continue the control of said corporation and its property" for the private benefit of the faithless directors, "and in fraud of the stockholders and the corporation." These allegations were held sufficient to authorize a single-stockholder to proceed. 104 Mass. 393.

*Brewer v. Boston Theatre*, 104 Mass. 378, always has been recognized as a leading and authoritative decision. It is exhaustive in its discussion. There has been no relaxation of the rule there laid down. On the contrary it has been strictly adhered to. It was followed in *Dunphy v. Travelers' Newspaper Ass'n*, 146 Mass. 495, 16 N. E. 426. In that case it was not alleged that the individual stockholder had attempted to move the directors to action in behalf of the corporation, but as excuse for this failure it was averred that one of the directors was president and treasurer of the corporation and was and had been for a long time the owner or controller of a majority of shares of its capital stock, and had improperly managed the corporation and wrongfully received to his own benefit large amounts of its money for salary and rent. There was no allegation of fraud, or of wrongful combination by this director with any others, or misconduct on the part of any of the others. It was held that it could not be presumed, in the absence of such averments, that the directors would refuse to do their duty in behalf of the corporation if they were asked to do so. To the same effect are *Doherty v. Mercantile Trust Co.*, 184 Mass. 590, 69 N. E. 335; *Enos v. Church of St. John the Baptist*, 187 Mass. 40, 43, 72 N. E. 253; *Young v. Haviland*, 215 Mass. 120, 123, 102 N. E. 338; *Von Arnim v. American Tube Works*, 188 Mass. 515, 517, 74 N. E. 680; *Wineburgh v. United States Steam & St. Ry. Adv. Co.*, 173 Mass. 60, 62, 53 N. E. 145, 73 Am. St. Rep. 261; *Richardson v. Clinton Wall Trunk Co.*, 181 Mass. 580, 64 N. E. 400. The record in *Hill v. Murphy*, 212 Mass. 1, 98 N. E. 781, 40 L. R. A. (N. S.) 1102, Ann. Cas. 1913C, 374, which was said to be "somewhat meager," showed far more effort to move the directors to action than is disclosed in the case at bar. *Hawes v. Oakland*, 104

U. S. 450, 26 L. Ed. 827; *Quincy v. Steel*, 120 U. S. 241, 247, 7 Sup. Ct. 520, 30 L. Ed. 624; *Doctor v. Harrington*, 196 U. S. 579, 588, 25 Sup. Ct. 355, 49 L. Ed. 606.

The present bill is like the bill in *Brewer v. Boston Theatre*, which was held insufficient and singularly unlike the amended bill, which there was held sufficient. The present bill avers that 10 individual defendants "are still directors of said corporation and influential in its councils. Said defendants and other directors closely associated and affiliated in financial matters constitute a majority of the board of directors controlling the action and policy of the corporation." This is far from an averment that the 10 defendant directors who have perpetrated the alleged wrongs against the corporation are in corrupt confederation with others of their associates in numbers sufficient to control the action of the board. Much less is it an averment that the 13 directors (other than those named as defendants), 2 of whom are alleged to have been directors since 1910, 3 since 1911, and the rest since 1913, are in collusion with the faithless directors. Thirteen out of the 23 directors are not alleged to have been guilty of any wrongful acts toward the corporation, nor are any facts averred to "show that they are willfully disregarding of the interests of the corporation," or that they "would yield to the influence or control" of those who have been guilty of negligence or ultra vires acts, if aware of the purposes to which that influence and control is exerted. The extent of the relation of any of the directors to those upon whom it is sought to fasten liability is that certain unnamed "other directors" are "closely associated and affiliated in financial matters" with them. This averment would be satisfied by the fact that they are together on a board of directors of a corporation involving financial interests of the magnitude of those vested in the New York, New Haven & Hartford Railroad. Such service may constitute close association and affiliation in financial matters. There is nothing sinister or corrupt in the single fact of association or affiliation in financial matters. There must be some further fact before there is anything wrong about it. "Affiliation \* \* \* in the same church" with a party to an action is no disqualification to a juror. *Searle v. Roman Catholic Bishop of Springfield*, 203 Mass. 493, 498, 89 N. E. 809, 25 L. R. A. (N. S.) 992, 17 Ann. Cas. 340. Service upon the same board of directors does not of itself make honest men truckle to the dominating influence of a corrupt minority merely by reason of being thus "closely associated and affiliated in financial matters." It is not the equivalent of saying that the majority refuses to act in the interests of the corporation by reason of tainted subserviency, or that it endeavors intentionally and intelligently to screen the guilty directors from their just responsibility to the corporation or that otherwise it is faithless to the trust resting upon directors. Allegations of this nature are wholly absent from the present bill. Unless *Brewer v. Boston Theatre* is overruled, plainly this bill cannot be maintained on its present allegations. This case is



indistinguishable from that. In its material averments in this respect the bill at bar is like that there held fatally defective, and omits those there held essential. The allegations of the paragraph to the effect that the guilty directors with other directors closely associated and affiliated in financial matters with them constitute a majority of the board and control the action and policy of the corporation, are not rendered sufficient by regarding them as supplemented by the averments of a preceding paragraph, in substance that the information contained in the official investigations and decisions, and all the records and accounts of the defendant corporation and its subsidiaries, have been open and accessible to the directors, and that it was their duty within a reasonable time to cause to be instituted appropriate proceedings for the recovery of the sums for which the individual defendants and the estates of deceased directors are liable to the corporation, and that the "extent of actual knowledge" which has come to the present directors "is unknown to the plaintiffs." Although this allegation is directed to a different proposition and is not pleaded in support of excuse for failure to move the directors to action, yet, if all the averments are combined, they fail to show any excuse for failure to give the directors reasonable time to act after the application, before instituting the present suit.

This rule of law, recognized 45 years ago after full consideration in *Brewer v. Boston Theatre*, 104 Mass. 378, has been steadily followed, not only here, but it prevails generally. See 10 Cyc. 966, 967, for a collection of cases. It is not a technical rule of pleading, but one of substantive right. If the majority of the board of directors of a corporation are incorruptible, free from collusion with wrongdoers, and ready to act for the best interests of the corporation, there is no reason why an individual stockholder should be permitted to involve it in law suits. As was said by Knowlton, J., in *Dunphy v. Travelers' Newspaper Ass'n*, 146 Mass. 495; 497, 16 N. E. 426, 431: "It would be contrary to the fundamental principles of corporate organization to hold that a single shareholder can at any time launch the corporation into litigation to obtain from another what he deems to be due to it, or to prevent methods of management which he thinks unwise."

Unless a plaintiff in equity is ready to state in court that he knows or that he is informed and believes and therefore avers the truth of the essential facts respecting the directors which show either that they have refused to act when asked to act or that it would be useless to make application to them, there is no reason why litigation should be undertaken by him for its benefit. The circumstance that there are general allegations that vast sums of money have been lost to the defendant corporation can make no difference in the application of the governing principles of law.

It follows that the bill is fatally defective in this respect and the demurrers must be sustained on this ground. It is unnecessary at this

time to consider any of the other numerous questions raised at the argument. Let the order be, demurrers sustained on the ground that the bill does not allege reasonable application to directors to institute proceedings to recover losses referred to in the bill, nor facts showing that such application would have been useless. So ordered.

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### GENERAL RUBBER CO. v. BENEDICT.

(Court of Appeals of New York, 1915. 215 N. Y. 18, 109 N. E. 96,  
L. R. A. 1915F, 617.)

CARDOZO, J.<sup>19</sup> This case comes here on a demurrer to a complaint. The plaintiff is a corporation. It is organized under the laws of New Jersey. The defendant is one of its directors. There is another corporation, organized in the same State, known as General Rubber Company of Brazil. The capital stock of the latter company is made up of three thousand shares; and all the shares, with the exception of eighteen, are held and owned by the plaintiff. For convenience, we shall refer to the plaintiff as the holding, and the General Rubber Company of Brazil as the subsidiary company. The general manager of the subsidiary company at Para, Brazil, was one Arnold J. Hutter. While acting as manager for that company, he became the manager of a rival business. This business was conducted at first under the name of E. Levy, and later, after a corporation had been organized, under the name of the Moju Company. The defendant was the owner of more than one-fourth of the stock. He was also its vice-president. The Moju Company met with reverses, and finally became insolvent. To relieve its embarrassments, Hutter, according to the allegations of the complaint, took the moneys of the General Rubber Company of Brazil and gave them from time to time to the Moju Company. The defalcations extended over a period of more than a year, and caused a loss of \$185,000. The charge is made that the defendant knew of this misuse of moneys, and that he acquiesced in it and approved of it. He neglected, it is said, to inform the plaintiff of Hutter's wrongdoing; he withheld and concealed the truth, so it is charged, intentionally and for his own profit; and the averment is that if such information had been given, the plaintiff could and would have prevented the misapplication and the loss. Because of this violation of his duty, the value of the plaintiff's shares in the subsidiary company is said to have been lessened, and the plaintiff to have been otherwise damaged, in a sum exceeding \$185,000. For the amount of this loss with interest, judgment is demanded.

The foregoing summary states in briefest outline the averments of a voluminous complaint. It suffices, however, to indicate the problem of law which is involved. We are to determine whether the defend-

<sup>19</sup> A portion of the opinion is omitted.

ant is liable to the holding company for the diminished value of its shares resulting from the waste of the assets of the subsidiary company.

The defendant was not a director of the subsidiary company. He was a director of the plaintiff. Because of that relation he owed to the plaintiff the duty of good faith and vigilance in the preservation of its property. The duty and the breach, coupled, it is here alleged, with damage, make out a cause of action. *Ashby v. White*, 3 Ld. Raym. 320. Such cases as *Smith v. Hurd*, 12 Metc. (Mass.) 375, 46 Am. Dec. 690, and *Niles v. N. Y. C. & H. R. R. Co.*, 176 N. Y. 119, 68 N. E. 142, are pressed upon us by the defendant. They are inapplicable here. The distinction was well put by Taft, J., writing for the Circuit Court of Appeals in *Ritchie v. McMullen*, 79 Fed. 522, 533, 25 C. C. A. 50, 61: "It is undoubtedly true, as the Circuit Court held, that a stockholder, merely as such, cannot have an action in his own behalf against one who has injured the corporation, however much the wrongful acts have depreciated the value of his shares (citing *Smith v. Hurd*, supra, and other cases). But we are of opinion that this principle has no application where the wrongful acts are not only wrongs against the corporation, but are also violations by the wrongdoer of a duty arising from contract or otherwise, and owing directly by him to the shareholders."

The stockholder in those cases did not sue his own agent. He sued another's agents, i. e., the directors of a company, and sued them for the waste of the company's property. In his own right, and not in a derivative action, he attempted to recover his own damages, which he measured by the diminution in the value of his shares. The decision was that the delinquent directors were the agents of the company; that they owed a duty to the company and not to the individual stockholders; and that if there had been any breach of that duty the company must redress the wrong. But here the situation is a different one. Here the stockholder is not suing the agent of another company; it is suing its own agent. The stockholder happens to be itself a corporation; the defendant happens to be a director; but the legal problem would be the same if the plaintiff were a natural person, and the defendant an executor or trustee. It would also be the same if the plaintiff, instead of being substantially the sole stockholder, were one stockholder among many. If the trustee of an estate, holding shares in a bank, should learn that the cashier was looting it, and with that knowledge should keep silent, the defendant would have us say that the beneficiaries under the will would have no remedy for the ensuing loss. A trustee in the case supposed would owe no duty of active vigilance to the bank whose property was stolen. If not liable to those interested in the estate, he would not be liable to any one. Yet his duty to preserve the estate, the breach of that duty, and the resulting damage, would seem to call for the application of the principle that there is no wrong without a remedy. The case supposed does not differ in its essence from the case presented. The defendant, as a director of a cor-



poration should have taken the same care of its property that men of average prudence take of their own property. *Hun v. Cary*, 82 N. Y. 65, 37 Am. Dec. 546; *Latimer v. Veader*, 20 App. Div. 418, 428, 46 N. Y. Supp. 823; *Bosworth v. Allen*, 168 N. Y. 157, 61 N. E. 163, 55 L. R. A. 751, 85 Am. St. Rep. 667. A jury might not unreasonably find that the care exacted by that rule would involve at least a warning that the subsidiary company was in the management of a thief, and that the value of the shares was vanishing. It is argued that even if the warning had been given, the plaintiff was only a stockholder in the subsidiary company, and hence was not in a position to stop the waste. The allegation is, however, that it could and would have done so; and we must hold this sufficient on demurrer. There are many things it could have done. It could at least have sounded an alarm that might have led to Hutter's removal. The trial will show whether its intervention would or would not have been efficient. In any event, we cannot say, and least of all as a matter of law, that the opportunity to intervene was valueless. *Leather Mfrs.' Bank v. Morgan*, 117 U. S. 96, 115, 6 Sup. Ct. 657, 29 L. Ed. 811; *Continental Nat. Bank v. Nat. Bank of Commonwealth*, 50 N. Y. 575; *Voorhis v. Olmstead*, 66 N. Y. 113, 118; *Rothschild v. Title Guarantee & Trust Co.*, 204 N. Y. 458, 97 N. E. 879, 41 L. R. A. (N. S.) 740; *Cassidy v. Uhlmann*, 170 N. Y. 505, 518, 521, 63 N. E. 554.

It is strongly argued, however, that the defendant is answerable for the same wrong to the subsidiary company, and is thus exposed to the risk of a double liability. We think the wrong to the plaintiff does not cease to be remediable because it may also be a wrong to some one else. If the defendant has violated any duty to the subsidiary company, it is not the same duty that he owes to the plaintiff. He is not liable to the subsidiary company qua director. He is not liable to that company for mere neglect. He is liable to it, if at all, only as a stranger might be liable. If he has joined in a conspiracy to plunder it, he must, like any other tortfeasor, make compensation for the plunder. There are allegations in the complaint which are broad enough to be construed as charging that he was a party to such a conspiracy. We cannot know whether they will be proved. If they are proved in all their fullness, they will show that the subsidiary company as well as the plaintiff has been wronged. Less, however, may be proved; the defendant may not have counseled or ratified Hutter's acts, or otherwise made himself a party to them; and still if he knew of them, and was silent, he may have failed in the stricter duty that he owes to the plaintiff. It is not for us at this time to say to what extent the duties are coterminous. It is enough that they have a different origin, a different standard, and a different measure.

The argument is made, however, that since the duties overlap, a double liability is threatened. To-day the defendant is called upon to make good the diminished value of the plaintiff's shares. To-morrow he may be called upon at the suit of the subsidiary company to re-

plenish its wasted treasury. We think the argument confuses the cause of action with the damages. If the defendant is solvent, and has so made himself a party to the conspiracy that he is liable as a tortfeasor to the subsidiary corporation, the existence of such a cause of action will be reflected, like the ownership of any other asset, in the value of the shares. The diminution in value will be one thing if the subsidiary corporation is without a remedy against any one. It will be another thing if there is a remedy against a solvent wrongdoer. It will be one thing if the cause of action in favor of the company is conceded or certain. It will be another thing if the cause of action is contested or doubtful. A contested claim is rarely appraised at its face value. The expenses of litigation, its delays, its uncertainties, these and like elements may make the shares less valuable, even though a remedy at the suit of the company exists, than they would be if the wasted moneys were back in the treasury. The extent of the reduction in value is to be measured by the jury.

We must keep in mind steadfastly the essential nature of the cause of action. It is not an action to restore to the subsidiary company the money that has been abstracted. It is an action to restore to the holding company the diminished value of its shares. If the subsidiary company were suing the defendant for a conversion of its assets, it would, of course, be no answer for him to say that there was a remedy also against Hutter. He would be bound to restore what he had taken, or permitted others to take. It is possible that if his offense was merely one of negligence, he might through subrogation have a remedy over against the principal offender. *Steele v. Leopold*, 135 App. Div. 247, 256, 257, 120 N. Y. Supp. 569, affirmed 201 N. Y. 518, 94 N. E. 1099; *Chillingworth v. Chambers*, L. R. (1896) 1 Ch. 685; *Moxham v. Grant*, L. R. (1900) 1 Q. B. 88. But in this action he is under a very different duty. Nothing has been taken directly from the plaintiff. What has been taken belongs to the subsidiary company. The defendant is not sued for a wrongful taking. He is sued for the wrongful failure to preserve the value of the plaintiff's shares. Only to the extent that the taking has made the individual shares less valuable, has a liability arisen. In such circumstances there is no right of action in favor of the plaintiff against the primary wrongdoer to which the defendant can be subrogated. The ultimate devolution of the burden must, therefore, be determined, not in some other action, but here and now. In these conditions, it becomes our duty, through a sound definition of the measure of damages, to work out a result which will be just alike to plaintiff and to defendant.

The existence of a cause of action does not depend, however, upon the extent of the recovery. If the subsidiary company has no remedy that will enable it to make good the loss, the reduction in the value of the shares may be equal to the fund converted. If it has a plain and certain remedy either against the defendant or against some other sol-

vent party to the wrong, the reduction in the value of the shares may be less than the converted fund, or, it may be, almost nominal. We can imagine a case where a director has borrowed money illegally, and may, therefore, be required to repay it. The corporation in such circumstances has a cause of action to compel the money to be restored, yet the value of the shares in the hands of the stockholders may not be reduced at all. Whatever difficulty there is in determining the measure of the loss is inherent in the very nature of these problems of appraisal. To determine the value of the shares, every asset of the subsidiary company must be reckoned, and the defendant's liability to that company, if it exists, must be included like any other.

We think, for these reasons, that the menace of a double liability is illusory. The defendant owes a duty to the plaintiff; if the complaint speaks truly, he has violated that duty; and to the extent of the resulting damage he must answer for the wrong. \* \* \*

COLLIN, J. (dissenting). The facts alleged as constituting a cause of action at law in favor of the plaintiff against the defendant, adequately stated for the purpose of this discussion, are: The plaintiff, a New Jersey corporation, owned, as an asset, all the three thousand shares of the capital stock of another corporation hereinafter denominated the Brazil company, except eighteen. The defendant was a director of the plaintiff. He was not a director of or connected with the Brazil company. An agent of the Brazil company, wrongfully and without the knowledge of it or the plaintiff and with the knowledge, acquiescence and approval of the defendant, abstracted from time to time, through the period of about one year, from its treasury and delivered to a third corporation, the Moju Company, moneys aggregating \$185,000, no part of which has been repaid to the Brazil company. The defendant owned about one-quarter of the issued shares of the capital stock, and was the vice-president of the Moju Company.

The defendant did not inform the plaintiff, which remained ignorant, while it progressed, of the misapplication of the moneys of the Brazil company. The plaintiff, had it known of the misuse, "could and would have taken such action as would have caused the funds and moneys (of the Brazil company) theretofore so misapplied to have been recovered and as would have prevented the said further misapplication of said funds and moneys to such wrongful uses." The Moju Company is insolvent. The misappropriations by the agent of the Brazil company of its moneys have lessened the value of the assets of the plaintiff, to wit, the shares of stock of the Brazil company in a sum exceeding \$185,000. Judgment for the said sum of \$185,000 with interest is prayed for.

Certain facts are clear. This is an action at law. The Brazil company was an independent legal being or entity, and its status was unaffected by the ownership of the plaintiff of its capital stock. *Buffalo Loan, T. & S. D. Co. v. Medina Gas & E. L. Co.*, 162 N. Y. 67, 76, 56 N. E. 505; *Saranac & L. P. R. Co. v. Arnold*, 167 N. Y. 368, 60 N. E.



647. The Brazil company owned exclusively the abstracted moneys. The plaintiff did not at law have right, title or interest in or to them, the whole title of which was in the despoiled corporation. *United States Radiator Corp. v. State of New York*, 208 N. Y. 144, 101 N. E. 783, 46 L. R. A. (N. S.) 585. The plaintiff, by virtue of its shares of the capital stock of the Brazil company, had merely the right to partake, proportionately, of the surplus profits or fund of the company as declared or distributed by its directors. *Burrall v. Bushwick R. Co.*, 75 N. Y. 211; *Plimpton v. Bigelow*, 93 N. Y. 592, 599; *United States Radiator Corp. v. State of New York*, 208 N. Y. 144, 101 N. E. 783, 46 L. R. A. (N. S.) 585. The action is not brought in behalf of the Brazil company. The pith of the alleged cause of action is, the abstraction of the moneys and the neglect of the defendant to inform the plaintiff of it.

The injury to the assets of the plaintiff was not direct, and came from and through the injury to those of the Brazil company. Those assets were not taken or directly injured or interfered with. They, as it is alleged, were depreciated in value by the "wrongful misappropriation" of the funds of the Brazil company, no part of which the plaintiff then owned or had a right to possess or control or has now the right to recover. The Brazil company owned them and was entitled to possess and dispose of them and it alone has the right to recover them. Whenever recovery or restitution of them is made to it, the alleged injury to the plaintiff will be obliterated. The subsequent disposition of them will be wholly within the authority of the Brazil company and it may naturally and lawfully result, through the hazards of business, that the plaintiff will not receive directly or indirectly any advantage from them. If at the commencement of this action the Moju Company or Hutter, the general manager and despoiler of the Brazil company, or this defendant had paid that company the sum abstracted, the plaintiff would not have had the alleged cause of action, because the plaintiff has no right to those moneys and upon their return to their owner, the Brazil company, it is not under any damages. If the defendant should pay the sum of them or any part to this plaintiff, he, under the allegations of the complaint, which permit proof that the defendant conspired with the agent of the Brazil company, would remain liable to the Brazil company for them, because they were taken from and belong to the Brazil company, but if he paid them to the Brazil company, he would not thereafter be liable to the plaintiff, because it had no right to them and its damage or loss would have been wholly remedied. There was but a single loss, although that loss may indirectly and collaterally affect the creditors and stockholders of the one loser, to wit, the Brazil company. A single recovery by the Brazil company would afford complete indemnity to the plaintiff and all interested parties. Each of the Brazil company and the plaintiff has not the right to recover the one hundred and eighty-five thousand dollars. The general rule of the law

is, that an action must be brought by the person having the title to the damages which are sought to be recovered for the injury and not the person or persons who are indirectly damaged by it.

If the defendant at his first knowledge of the spoliation during its progress had informed the plaintiff of it, the plaintiff would not have had the right to any of those moneys or any damages, a fact which the complaint recognizes in the averment that if he had done so "the plaintiff could and would have taken such action as would have caused the funds and moneys (of Brazil company) theretofore so misapplied to have been recovered and as would have prevented the said further misapplication of said funds and moneys to such wrongful uses." The quoted allegation is a conclusion of law based upon the ownership by the plaintiff of nearly all of the capital stock of the Brazil company, but treating it as an allegation of fact, there remains the truth that the plaintiff has not been injured by the neglect of the defendant. The power and authority which it then had to cause the Brazil company to recover the misapplied funds, it still has. While the Moju Company is insolvent, Hutter, the agent of the Brazil company, and this defendant, presumptively, are solvent. Solvency of the individual, no refuting circumstance appearing, is presumed. *First National Bank of Meadville v. Fourth National Bank, N. Y. City*, 77 N. Y. 320, 33 Am. Rep. 618; *Potter v. Merchants' Bank of Albany*, 28 N. Y. 641, 86 Am. Dec. 273. The plaintiff in proving the alleged cause of action would prove a cause of action in favor of the Brazil company against Hutter and this defendant, as tortfeasors, through which that company could recover the full amount of the funds appropriated by them with interest—a result the equivalent of that obtainable under full and immediate information of the misappropriation to the plaintiff by the defendant. The plaintiff is seeking to recover, through the alleged wrong of the defendant, a sum which it never had, and would not have had if the defendant had told it all that he knew, which is recoverable by the Brazil company, and the recovery of which by the company will make whole the value of the plaintiff's shares of its stock. The law does not permit such a result.

In *Wells v. Dane*, 101 Me. 67, 63 Atl. 324, the plaintiff was a shareholder in the corporation, and brought the action against the defendants, officers of the corporation, to recover damages, alleging that the wicked and wrongful acts were with the specific intent and malicious and fraudulent design of injuring the plaintiff. The court held that the plaintiff did not have a cause of action, and for reasons which I think determine the question here in accord with complete and final justice. It said: "There may be cases of injuries to the individual rights of the shareholder where he and not the corporation must seek redress, such for instance as the levying of an unlawful tax on shares held by the individual stockholder, mutilation or destruction of his certificate, or circulating false and scandalous reports or issuing spurious certificates thus creating uncertainty as to the title or validity of



existing shares. In all such cases, however, the wrongful act affects the shares directly. They are readily distinguished from the case at bar, where the plaintiff claims his shares were depreciated by wrongful acts making possible the issue of six hundred shares of stock without payment therefor. Such a wrong being primarily against the corporation, the redress for it must be sought by the corporation. \* \* \* Whatever injury befell him he suffered as a stockholder; and in a case like this, where the direct injury was to corporate rights and interests, the right to share in the compensation which the corporation may recover passes to the transferee of the plaintiff's shares. *Winsor v. Bailey*, 55 N. H. 218. Neither does it matter that the misconduct is charged against the defendants as individuals and not as officers. By whomsoever the wrongful acts were committed and in whatsoever capacity the wrongful doers acted, their acts directly injured the corporate body. Redress must be sought by the party injured. The plaintiff was injured only indirectly and collaterally. When the corporation is indemnified the plaintiff ceases to be a loser. It is for the reason, viz., that the plaintiff sustained no loss in addition to the loss to the corporation, that the action cannot be maintained notwithstanding the allegation that the wrongful acts were done with the specific intent and malicious and fraudulent design of injuring the plaintiff. If the plaintiff had suffered any loss in addition to that suffered by the corporation such an allegation would be sufficient although the injury suffered was indirect and consequential. *Gregory v. Brooks*, 35 Conn. 437, 95 Am. Dec. 278; *St. J. & L. C. R. Co. v. Hunt*, 55 Vt. 570, 45 Am. Rep. 639. In those cases a wrongful act was done to one with an unlawful intent and design to indirectly injure another, and both were injured. Here there is but one loser and one injury. When the injury is to the collective rights of the shareholders and the corporate property is made good, the plaintiff, who has suffered only in these, will be fully indemnified. There is therefore nothing for which he can maintain a separate suit. Where there is but one loss and one loser there can be but one suit, and that must be by the party who has suffered the loss." See, also, *Allen v. Curtis*, 26 Conn. 456; *Niles v. N. Y. C. & H. R. R. Co.*, 176 N. Y. 119, 68 N. E. 142.

The gist of the wrong in any aspect is the abstraction of the moneys which were those of the Brazil company, and that company's ownership of the damages resulting from it. It is true that in the present case the defendant was a director of the shareholder, and it is alleged that such relation gave an additional element to his wrong-doing, making him liable to the plaintiff. But the fundamental facts exist that the direct and primary injury and single loss is to the Brazil company; that the loss to the plaintiff was simply an indirect consequence of that loss and not additional to or independent of it; that the Brazil company can recover its loss and that being done the plaintiff will be fully indemnified. The fact that the despoilers of the Brazil company were not its directors does not affect the natural results of their acts and is im-



material. *Wells v. Dane*, 101 Me. 67, 63 Atl. 324; *Converse v. United Shoe Mach. Co.*, 185 Mass. 422, 70 N. E. 444.

The case of *Ritchie v. McMullen*, 79 Fed. 522, 25 C. C. A. 50, does not conflict with the foregoing reasoning and conclusions. There the defendant directors of the corporation were pledgees of the plaintiff's shares of its capital stock, and combined together and wrongfully reduced the value and income of the pledged shares with the intention of defaulting the pledgor, forcing the shares to a public sale, depriving the plaintiff of the means of redeeming them or buying them in, of buying them in at less than their value, and of thus increasing their holdings and causing the plaintiff to cease to be a stockholder and lose the benefits from his development of the properties. The basis of the decision there was that the pledgees used their positions as majority directors and their votes as stockholders intentionally to depreciate the stock of their pledgor with the dishonest purposes as mentioned. Clearly, the injury to the plaintiff was direct and peculiar. The case, in this aspect, belongs to the class of which is *St. J. & L. C. R. Co. v. Hunt*, 55 Vt. 570, 45 Am. Rep. 639. For the reasons stated, I vote for reversal.

CHASE, MILLER and SEABURY, JJ., concur with CARDOZO, J. COLLIN, J., reads dissenting opinion, and HISCOCK, J., concurs. WILLARD BARTLETT, C. J., absent.

Order affirmed.

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## XII. Expulsion of Members <sup>20</sup>

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### BARRY v. THE PLAYERS.

(Supreme Court of New York, Appellate Division, First Department, 1911. 147 App. Div. 704, 132 N. Y. Supp. 59.)

Appeal from Special Term, New York County.

Application for mandamus by Richard Barry against The Players to reinstate him as a member of respondent, a social club. From an order of a Special Term (73 Misc. Rep. 10, 130 N. Y. Supp. 701) denying a motion for a peremptory or alternative writ, petitioner appeals. Reversed, and peremptory writ granted.

SCOTT, J. Appeal from an order denying relator's application for a writ of mandamus to reinstate him as a member of the respondent, a social club.

The respondent was incorporated in 1888; its purpose and objects being thus described in the certificate of incorporation: "That the particular business and objects of our society or club, so formed, are

<sup>20</sup> For discussion of principles, see *Clark on Corp.* (3d Ed.) § 152.

the promotion of social intercourse between the representative members of the dramatic profession, and of the kindred professions of literature, painting, sculpture and music, and the patrons of the arts; the creation of a library relating especially to the history of the American stage, and the preservation of pictures, bills of the play, photographs and curiosities connected with such history."

The club has a membership of 1,034 of whom 40 per cent. are members of the dramatic profession or in some way connected in business or art with the stage. How many are actors does not appear. The constitution of the club provides that any member may be suspended or expelled "for cause" by a vote of two-thirds of the board of directors; notice and a copy of the charges having been given to the accused member. The relator has been a member of the club since 1907 and is a writer and author by profession. On April 15, 1911, relator was served with a charge of misconduct and a notice of hearing thereon. The charge read as follows: "That Mr. Richard Barry, a member of The Players, has been guilty of conduct unbecoming an associate of members of an honorable profession in publishing of and concerning them the following libelous statement in Pearson's Magazine for March, 1911; 'Very few persons on the stage know how to think. In fact, few of them know how to feel, though they all make some sort of bluff at it. Education is unnecessary; general association with humanity is tabooed, and few of the profession read enough to have any grasp on things of the mind. So the matter of sex never enters into the question of pay, except it be to favor the woman,'"

The relator did not appear in person in answer to the charge, although he offered to do so if requested, but he submitted a written answer in which he protested that nothing in the article upon which the charge was founded reflected expressly or by fair implication upon those members of the dramatic profession who were members of the respondent club. He also submitted the text of the whole article written by him in which the paragraph quoted in the charge appeared. This article, which had appeared in a popular magazine, was written in the fashion which has become familiar to magazine readers of the present day in which literary style and grace is sacrificed to vigorous and dogmatic expression, doubtless with a view to arresting the attention of general readers. The purpose of the article was to demonstrate what the writer believed to be the disadvantage at which women found themselves when placed in competition with men in industrial pursuits. He found that the dramatic profession furnished an exception to the general rule, and alleged that "on the stage one never hears complaint that men get more money than women." Then followed the words quoted in the charge, which were apparently intended to account for the phenomenon that, on the stage, women were as well paid as men. No question is made as to the regularity of the proceeding leading to relator's expulsion, which fol-

lowed upon the presentation of his defense, and the only question presented by the appeal is as to the sufficiency of the charge to justify an expulsion.

It will be observed that the authority given by the constitution to the directors is to expel or suspend "for cause"; but no precise definition is given as to what shall be deemed to constitute cause. It is generally agreed, however, both in this country and England, that sufficient cause must consist either of an offense against the member's duty as a corporator, or of a serious offense against his duty as a citizen, or of an offense against both duties (*Evans v. Phila. Club*, 50 Pa. 107; *People v. Med. Soc.*, 24 Barb. 570), and in the nature of the case this must necessarily be so, since a club has no authority or jurisdiction to deal with a member except in his relation to the club. In order to justify expulsion, therefore, a member must be charged with and proven guilty of conduct which can in some fair sense be said to be "improper and prejudicial to the club" (*Loubat v. Le Roy*, 15 Abb. N. C. 1-20). The English courts have perhaps gone somewhat further than have our own in conceding finality to the judgment of a club committee as to what conduct is improper and prejudicial; but I do not understand that there is any substantial difference of opinion as to the rule that to justify expulsion the cause must be conduct "improper and prejudicial to the club," which, I understand to mean, conduct which in some way or to some degree tends to injure the club materially or in reputation, or is contrary to and destructive of the purpose of its organization. Otherwise, a member might be expelled arbitrarily and upon insufficient grounds, and this may not be done. In *re Haebler v. N. Y. Produce Exchange*, 149 N. Y. 414, 44 N. E. 87; *People ex rel. Ward v. Uptown Ass'n*, 9 App. Div. 191, 41 N. Y. Supp. 154.

It will be observed upon a reading of the charge against relator that he is not accused of doing anything to the prejudice of the club or its members. In fact, neither the name of the club nor any reference to it appears in the charge or in the article complained of. The charge is that his conduct is "unbecoming an associate of members of an honorable profession," which amounts to little more than an accusation of bad taste on the part of the writer. It is certainly not easy to see how the expression of relator's unflattering estimate of all but a few of the persons on the stage constitutes an offense against the club, or tends in any way to injure it or destroy its usefulness. It might lead to a coolness, or even a suspension of social relations between relator and some of his club fellows; but as was remarked by Mr. Justice Cullen in *People ex rel. Ward v. Uptown Ass'n*, *supra*: "It may be unfortunate that there should be a difference of opinion or disputes in club management; but dissension is a hazard to which all associate action is liable, and clubs no more than other organizations can expect to be exempt from this hazard."

If a member of a yacht club were to say "that few yachtsmen could



sail their own boats or knew the science of navigation," it might make him unpopular with some of his fellow members, but could scarcely be said to reflect upon the club as an organization. Even in their resolution giving their reasons for expelling the relator, the directors did not say or even intimate that relator had been guilty of conduct prejudicial to the club. They resolved, as recited by their secretary: "That the said publication by Mr. Barry mentioned in the charge expressed a contemptuous opinion of the members of the theatrical profession, of which the membership of the club was largely composed; that the said publication was unbecoming an associate of the members of that honorable profession; that it was false and libelous; that it was not explained nor extenuated nor justified by anything contained in his answer and was a good and sufficient cause for his expulsion from membership."

We are unable to find from first to last, in the charge or in the judgment rendered thereon, any declaration on the part of the directors that in their opinion the conduct of the relator had been prejudicial to the club. On the contrary, the sole conclusion which we may draw from their utterances is that relator had proven himself to be an undesirable member of the club. This is not sufficient to warrant expulsion, although it would be a quite sufficient reason for a refusal to elect him if he were an applicant for membership. The learned counsel for the respondent, however, asks us to go further than any court has yet gone, and to hold that the expulsion should be sustained, because it is very improbable that, after the publication of his article, the respondent, if an applicant for membership, could be elected. That test, however, cannot be applied for the very sufficient reason that, speaking generally, no man has any legal right to become a member of a social club and may be refused election for any reason at all, or capriciously or arbitrarily, but, once having become a member, he is entitled to remain such so long as he abides by the rules of the club, and performs his duty as a member, and cannot be arbitrarily or capriciously expelled. On the whole, while the relator's article may have given just offense to some of the club's members, we cannot say that its publication was prejudicial to the club or constituted conduct incompatible with relator's duty to the club. The expulsion was therefore unjustified.

Order reversed, with \$10 costs and disbursements, and motion for a writ of peremptory mandamus granted, with \$50 costs.

LAUGHLIN, CLARKE, and MILLER, JJ., concur.

INGRAHAM, P. J. I dissent from the reversal of this order. The Players Club was organized in the year 1888; the particular objects being the promotion of social intercourse between the representative members of the dramatic profession and of the kindred professions of literature, painting, sculpture, and music, and the patrons of the arts. By the constitution, to which the plaintiff when he became a member of the club subscribed (article 12), it was provided: "Any member

may be suspended or expelled for cause by a vote of two-thirds of all the members of the board of directors; one month's previous notice in writing having been given to the member with a copy of the charge preferred against him."

The "cause" which would justify the board of directors in expelling a member is not specified, but necessarily the cause must be one which would in a substantial manner affect the interests of the club, or such conduct as to show that the member against whom charges were presented should not continue to be a member of the club. Under this provision of the constitution a broad discretion was vested with the directors. It was for them to determine whether the conduct of a member was such that his continued membership would be an injury to the club or would be inconsistent with the objects for which the club was organized. It was this particular association organized to promote intercourse between the representative members of the dramatic profession and of the kindred professions of literature, painting, sculpture, and music, and the patrons of the arts, that was in question, and it seems to me that any act of a member that could possibly affect this object for which the club was organized would be a "cause" which would justify the directors in determining the question as to whether the members should be suspended or expelled. It might be that the conduct of the relator in a club or organization organized for another purpose would not justify his suspension or expulsion; but we have to consider the purpose for which the defendant was organized in determining when his conduct was such as did or tended to affect the welfare of the club. Certainly the court has not the right to substitute its judgment for that of the directors in determining the sufficiency of the cause. When a body of men associate themselves together for purely social purposes, where no pecuniary rights are involved, and where the constitution of the association expressly gives to the directors broad discretion as to suspension or expulsion, it seems to me that, when a court is asked to review the action of the directors acting within the express powers conferred upon them, the question mainly resolves itself into one of good faith and the exercise of that discretion should not be interfered with except in an extreme case where the charges are so clearly frivolous as not to call upon the directors for the exercise of the discretion expressly conferred upon them.

The object of this association, as before stated, was the promotion of social intercourse between the representative members of the dramatic profession, and of kindred professions of literature, painting, sculpture, and music, and the patrons of the arts. The relator was accused of having written a magazine article directly reflecting upon the members of the dramatic profession, and I think it appears from the papers in opposition to this application that the publication of this article had caused intense indignation among the members of the club who belonged to the dramatic profession. Whether we think members

of the dramatic profession should have been incensed at this publication or not seems to me to be immaterial. As a matter of fact they were. We will assume that the relator belonged to the profession of literature, and thus was a member of one of the professions within which it was the object of the club to promote social intercourse. If a member of the profession of literature had so conducted himself as to cause irritation and exasperation among the members of the dramatic profession who belonged to the club, his conduct would be such as would tend to make social intercourse impossible and not promote it, and thus his conduct would tend to defeat the object for which the club was formed, instead of promoting it. Thus charges against a member of such a club of conduct which directly tended to defeat the objects for which the club was organized were, I think, within this provision of the constitution and justified the directors in taking cognizance of the charges and determining whether or not they required suspension or expulsion. Having arrived at this conclusion, it seems to me necessarily to follow that, the directors acting within the authority conferred upon them, and exercising the discretion expressly given to them by the constitution by which the relator is bound, the court had no authority to review the exercise of that discretion.

In *Loubat v. Le Roy*, 15 Abb. N. C. 1, it was said that, in order to justify expulsion, a member must be charged with and proven guilty of conduct which can in some fair sense be said to be improper and prejudicial to the club. If he is charged with conduct which itself tends to destroy the objects for which the club was organized, and which did have that effect upon a substantial number of the members of the club, then it seems to me that such conduct was prejudicial to the club and the objects which it was formed to promote. I do not understand that the courts of this state have ever approved to its full extent the case of *Evans v. Pennsylvania Club*, 50 Pa. 107; but, even adopting the rule laid down in that case, it seems to me that, when it appeared that the conduct of the appellant had caused in the minds of a substantial number of the club members a feeling of anger and resentment which would tend to destroy the harmony and intercourse which the club was organized to promote, it can be said that the appellant was guilty of conduct which in a fair sense was prejudicial to the club.

I think, therefore, that the order appealed from should be affirmed.<sup>21</sup>

<sup>21</sup> The order of the Appellate Division was affirmed without opinion. 204 N. Y. 669, 97 N. E. 1102.



XIII. Forged and Unauthorized Transfers <sup>22</sup>NATIONAL SAFE DEPOSIT, SAVINGS & TRUST COMPANY  
v. HIBBS.(Supreme Court of United States, 1913. 229 U. S. 391, 33 Sup. Ct. 818,  
57 L. Ed. 1241.)

In Error to the Court of Appeals of the District of Columbia to review a judgment which affirmed a judgment of the Supreme Court of the District, in favor of defendant in an action for conversion. Affirmed.

Mr. JUSTICE DAY delivered the opinion of the court:

This case is in this court upon writ of error to the judgment of the court of appeals of the District of Columbia (32 App. D. C. 459), affirming the judgment of the supreme court of the District of Columbia in an action brought by the plaintiff in error, hereinafter called the bank, against the defendant in error, for the alleged conversion of certain shares of stock. The case was tried upon an agreed statement of facts, from which it appears:

The plaintiff in error has been doing a general banking business in the city of Washington, including the making of loans to its customers on promissory notes secured by stock collateral, and, to a limited extent, the buying and selling of stock for its customers and occasionally for itself.

On March 12, 1903, the bank made a loan to one T. M. Kelley of \$12,500, for which he gave his promissory note, payable on demand, and deposited with the bank certain stock certificates of the Mergenthaler Linotype Company as collateral security. Each of the certificates stood in the name of T. M. Kelley, and on its face recited that it was transferable by him, in person or by proxy, only upon the books of the company upon surrender of the certificate, and each upon its back contained an assignment with power of attorney to transfer the stock upon the books of the company, signed in blank by Kelley, whose signature was duly attested.

One Willard H. Myers had been in the continuous employ of the bank for over twenty years, and had committed no acts inconsistent with his duty to the bank, and was trusted as a faithful employee. During the last ten years of his employment he had been general book-keeper and assistant note teller, a part of his duties being to receive and enter upon the cash book of the bank the payment of loans by customers, and to procure from one of the officers of the bank and deliver to such customers the collateral security pledged for the loans,

<sup>22</sup> For discussion of principles, see Clark on Corp. (3d Ed.) §§ 163-166.

it being usual, in the ordinary course of business, for the bank to thus deliver certificates to him upon his request. He had no authority and it was not a part of his employment to dispose of, by sale, pledge, or otherwise, any stock held as collateral by the bank, or owned by it or any of its customers.

On May 26, 1904, Myers requested the secretary of the bank to procure from the vault where such securities were kept the certificates deposited by Kelley, whereupon the secretary delivered the certificates to Myers, in the usual course of business, for the purpose of having them returned to Kelley, similar requests having been made by Myers prior thereto. Kelley had not paid the loan or asked for the delivery of the stock, and Myers made no entry in the cash book.

The day following, May 27th, Myers delivered two of such certificates to the cashier of the defendant in error, a stock broker, for sale on his account, and at the request of the cashier, as was the usual custom where the signatures of the assignor and attesting witness are unknown, Myers, as a further identification of such signatures, signed his name to the attestation clause of the assignment. The defendant in error being out of the city, the certificates were turned over to another broker, by whom they were on that day sold on the Washington stock exchange, and on the same day Myers received the check of the defendant in error for the proceeds of the sale, which he subsequently cashed.

Myers did not represent to the cashier of the defendant in error that he was selling the stock for the bank, or that he was acting for it in any way, or indicate that he did not own the stock, nor did the defendant in error or his cashier know or have cause to suspect that the stock did not belong to Myers. The stock was sold, however, without the knowledge or consent of the bank or Kelley. By the custom of banks, brokers, and others dealing in stock, which custom was known to the bank, the possession of stock certificates assigned in blank and attested, as were the certificates here in controversy, has been recognized, in the absence of knowledge or cause of suspicion to the contrary, as evidence of ownership or of authority to sell, pledge, or otherwise deal with such certificates as the owner might do.

Certain of the other certificates deposited by Kelley were disposed of by Myers, some in like manner, through the defendant in error, for which Myers received the proceeds, others being hypothecated with the American Security & Trust Company, while the rest were surrendered by Myers to the authorities.

In this case conflicting legal principles are invoked and relied upon. For the defendant in error the familiar principle "that where one of two innocent persons must suffer by the acts of a third, he who has enabled such third person to occasion the loss must sustain it" is advanced. The plaintiff in error invokes the principle that where the owner of property, such as stock certificates, has lost it by the criminal

or fraudulent act of another, the owner, not voluntarily or negligently conferring upon such another the indicia of ownership or apparent title, cannot be deprived of his property by the attempted transfer of title to a third person for value, no matter how innocent the purchaser may be of knowledge of the crime or fraud by which the property was acquired.

In this case the diligence of counsel has called to the attention of the court many cases more or less applicable to the facts herein involved. We will not stop to pass them in review. It is enough to say that they have been attentively considered.

Stock certificates are a peculiar kind of property. Although not negotiable paper, strictly speaking, they are the basis of commercial transactions large and small, and are frequently sold in open market as negotiable securities are. In *First Nat. Bank v. Lanier*, 11 Wall. 369, 377, 20 L. Ed. 172, 174, this court said: "Stock certificates of all kinds have been constructed in a way to invite the confidence of business men, so that they have become the basis of commercial transactions in all the large cities of the country, and are sold in open market the same as other securities. Although neither in form or character negotiable paper, they approximate to it as nearly as practicable. \* \* \* Whoever in good faith buys the stock, and produces to the corporation the certificates, regularly assigned, with power to transfer, is entitled to have the stock transferred to him."

These principles are well known to business men and are constantly acted upon by them. This circumstance should be given due weight in determining the rights of the parties in this case.

In *Russell v. American Bell Teleph. Co.*, 180 Mass. 467, 62 N. E. 751, a certificate of stock signed in blank was delivered to an agent for the purpose of surrendering it to the company in order to obtain a new certificate. He wrongfully obtained an advance on the strength of the certificate by putting it in pledge. Dealing with the contention that the case was like one where the certificate had been stolen, and therefore no title could be transferred, Mr. Justice Holmes, delivering the opinion of the court, said: "In *Scollans v. E. H. Rollins & Sons*, 179 Mass. 346, 88 Am. St. Rep. 386, 60 N. E. 983, it is admitted that the general principle there laid down would not apply to an instrument indorsed in blank and stolen before it had been transferred. We shall not examine the premises of this defense because we cannot accept the conclusion. The qualification of the rule, as not applying when the instrument is stolen, is not based upon the name of the agent's crime, but upon the fact that, in the ordinary and typical case of theft, the owner has not intrusted the agent with the document, and therefore is not considered to have done enough to be estopped as against a purchaser in good faith. He certainly has not done enough if the estoppel is based upon the principle that when one of two innocent persons is to suffer, the sufferer should be the one whose confidence put into the



hands of the wrongdoer the means of doing the wrong. But in a case like the present, the agent has been intrusted with the converted property, and it is totally immaterial whether, by a stretch which extends larceny beyond the true field of trespass, his wrong has been brought within the criminal law or not. The ground of the estoppel is present and the estoppel arises. The distinction is not new. On the one side are cases like *Knox v. Eden Musee American Co.*, 148 N. Y. 441, 31 L. R. A. 779, 51 Am. St. Rep. 700, 42 N. E. 988, where an agent or servant simply had access to a document remaining in the possession of the owner; on the other, cases like *Pennsylvania R. Co.'s Appeal*, 86 Pa. 80, where possession is intrusted to the agent for one purpose and he uses it for another. It cannot matter in the latter class that the agent intended the fraud from the outset."

We think this case correctly states the principle, and, applied to the case in hand, is decisive of it. Here one of two innocent persons must suffer and the question at last is, Where shall the loss fall? It is undeniable that the broker obtained the stock certificates, containing all the indicia of ownership and possible of ready transfer, from one who had possession with the bank's consent, and who brought the certificates to him, apparently clothed with the full ownership thereof by all the tests usually applied by business men to gain knowledge upon the subject before making a purchase of such property. On the other hand, the bank, for a legitimate purpose, with confidence in one of its own employees, intrusted the certificates to him, with every evidence of title and transferability upon them. The bank's trusted agent, in gross breach of his duty, whether with technical criminality or not is unimportant, took such certificates, thus authenticated with evidence of title, to one who, in the ordinary course of business, sold them to parties who paid full value for them. In such case we think the principles which underlie equitable estoppel place the loss upon him whose misplaced confidence has made the wrong possible.

✓  
Bank Applying this principle, we think the Court of Appeals was right in affirming the judgment of the Supreme Court, and its judgment is affirmed.

#### XIV. Liability of Corporation Arising from Unauthorized or Invalid Transfer <sup>23</sup>

##### WOOTEN v. WILMINGTON & W. R. CO.

(Supreme Court of North Carolina, 1901. 128 N. C. 119, 38 S. E. 298,  
56 L. R. A. 615.)

MONTGOMERY, J.<sup>24</sup> This case was heard in the court below upon an agreed state of facts, those material to the decision of the case being as follows: Eliza Claudia Bradley died in 1854, leaving a last will and testament, in which she bequeathed to her son Charles W. Bradley 20 shares of capital stock of the Wilmington & Raleigh Railroad Company (now the Wilmington & Weldon Railroad Company), registered in her own name on the stock ledger of the company, to be held by him in trust for the sole and separate benefit of the testatrix's daughter Lucy A. Jewett during her life, and upon her death to the use and benefit of such children as she might leave surviving her. On December 1st following, Charles W. Bradley and James A. Bradley, the duly-qualified executors named in the will, transferred the 20 shares of stock on the books of the company "to Charles W. Bradley, trustee for Lucy A. Jewett," and a new certificate of stock was issued by the company in those words. In July, 1869, Charles W. Bradley, trustee, transferred the stock to Lucy A. Jewett absolutely, the word "trustee" appearing on the company's transfer ledger after Bradley's name, and a new certificate of stock was issued by the company to Mrs. Jewett individually. Afterwards, in the same year (1869), after her husband's death, Mrs. Jewett sold and transferred the stock to other persons absolutely, and new certificates of stock were issued to the purchasers, but the stock cannot now be identified nor its ownership traced. The stock was not sold by the executors to pay the debts of Mrs. Bradley, the financial condition of her estate not requiring a sale for that purpose. The defendant company had no knowledge of the condition of Mrs. Bradley's estate, and no actual knowledge of the contents of her will. Mrs. Jewett died in 1898, and the plaintiffs are her children, except the plaintiff Edward Wooten, who intermarried with Eliza Yonge Jewett.

The action is brought to recover from the defendant the value of the stock and the increment, by way of dividends, which has accrued since the death of Mrs. Jewett. The question for decision, then, is this: Does the transfer of the stock of a corporation on the books of the company by an executor fix the corporation with knowledge of the

<sup>23</sup> For discussion of principles, see Clark on Corp. (3d Ed.) §§ 168, 169.

<sup>24</sup> A portion of the opinion is omitted.

contents of the will? If so, then the transfer of the stock by the executors of Mrs. Bradley to Mrs. Jewett was wrongful, because the trust created in the will in favor of the plaintiffs was not observed in the transfer, and the plaintiff would be entitled to recover the value of the stock and the accrued dividends since the death of Mrs. Jewett.

It is incumbent on a corporation to protect the rights of persons interested in the stock of the corporation, against unauthorized transfer of the stock. *Cox v. Bank*, 119 N. C. 302, 26 S. E. 22; *Lowry v. Bank*, 15 Fed. Cas. 1040. The contention of the plaintiffs is that, when the executors of Mrs. Bradley transferred on the books of the company the stock to Charles W. Bradley as trustee for Mrs. Jewett, the company was fixed with knowledge of the contents of the will, and that in the transfer the trust in favor of the children of Mrs. Jewett, the plaintiffs, should have been preserved, under the provisions of the will; that the defendant should have seen that the transfer should have been made to Charles W. Bradley in trust, or as trustee for Mrs. Jewett for her life, and at her death to her children who might survive her. The plaintiffs further contend that the defendant also committed a wrongful and unlawful act in permitting on its books the transfer of the stock by Charles W. Bradley, trustee of Mrs. Jewett, to his cestui que trust, absolutely, and the transfer by Mrs. Jewett to others.

The defendant insists that, as the stock on the books stood in the name of Mrs. Bradley, the only thing necessary for it to take notice of, when an entry of transfer of the stock should be requested to be made on the books, was the exhibition to it of the letters testamentary from the proper court by the executors, the transfer to follow as a matter of course, according to the directions of the executors; that the executors, so far as defendant's liability is concerned, could have sold and transferred not only the stock, notwithstanding it was specifically bequeathed, but that they could have done so even in fraud, provided the company had no reasonable ground to believe that they were acting fraudulently, or disposing of the money for their own benefit in the transaction, and that they could have negligently or fraudulently failed to execute the trust imposed by the will upon them in reference to this stock and its transfer, provided the defendant did not have actual knowledge or information, which might reasonably put them on their guard concerning the fraud or negligence, at or before the time of the transfer, and on the ground that in law the personal property of a testator is vested in the executor, with the right to sell or dispose of it, and that the company was not compelled to take notice of the contents of the will. \* \* \*

In support of its position, the defendant's counsel referred the court to the cases in our own Reports of *Tyrrell v. Morris*, 21 N. C. 559; *Gray v. Armistead*, 41 N. C. 75; *Bradshaw v. Simpson*, 41 N. C. 246; *London v. Railroad Co.*, 88 N. C. 584; *Wilson v. Doster*, 42 N. C. 231; to the Bank of England Cases on the same subject; to *Hutchins v.*



Bank, 12 Metc. (Mass.) 421, especially, among other decisions of other states; to *Thomp. Corp.* § 2531; *Schouler, Ex'rs*, § 351; 1 *Cook, Corp.* § 330, and *Lowell, Stocks*. We will now examine these citations of the defendant.

We think the cases referred to in our own Reports have no application directly to the question to be decided. They are upon a point about which there is no controversy, to wit, that executors and administrators having the right of property in the personal property of the decedent have therefore the right to sell securities of the estate, and the mere fact of selling is no breach of trust, and a purchaser is not liable without actual notice that the administrator intended to misapply the funds or to use them for his own purpose; for the purposes of the estate may require the representatives to dispose of it. In 1 *Cook, Corp.* § 330, there is a treatise concerning the sale of stock by executors and administrators, and the rights and duties of corporations in allowing and refusing to allow a registry on the corporate transfer book of the sale of the stock by an executor or administrator, and the concluding part of the section is read: "In general, a corporation has a right to assume that the executor is transferring stock for the purposes of the estate. It is not obliged to inquire into the purposes of the party, nor to investigate whether the transaction is in good faith or fraudulent, nor to examine the will."

That seems to sustain the defendant, although the matter treated of is the sale of stock, and not the registration of the transfer of stock to a legatee, and its effect upon the corporation, without taking notice of the contents of the will. But the only case cited under that section (*Smith v. Railroad Co.*, 91 Tenn. 221, 18 S. W. 546) is diametrically opposed to the doctrine of the text. In that case the owner of the stock died testate, but without having named an executor. An administrator cum testamento annexo was appointed, and he delivered a part of the stock to a legatee named in the will absolutely, although she had only a life estate therein, and had the same transferred to the legatee on the books of the corporation. He made the transfer as administrator simply, without the words "cum testamento annexo." The court said there: "We are of the opinion that upon the facts of this case the corporation is not now liable to an action on this ground. It had no knowledge that there was a will limiting the title of Fannie Baugh to this stock, and there were no circumstances connected with the transfer by Mr. Howe, as administrator, calculated to put it upon inquiry as to the existence or terms of a will. He assigned the certificate standing in the name of his decedent simply as administrator. If he had assigned as administrator cum testamento annexo, it would have been notice of a will. The assignment was to the 'heirs and distributees,' not legatees, of J. W. Baugh. In this respect, the case is to be distinguished from *Covington v. Anderson*, 16 Lea (Tenn.) 310, and

Caulkins v. Gaslight Co., 85 Tenn. 685, 4 S. W. 287, 4 Am. St. Rep. 786."

Section 2531 of Thompson's Commentaries on the Law of Corporations contains the broad statement that the "letters testamentary show an apparent right to dispose of the stock of the testator, even though bequeathed specifically, and, on principle, the company is bound to respect his title, and transfer them according to his desire." And the cases of Bayard v. Bank, 52 Pa. 232, and Hutchins v. Bank, 12 Metc. (Mass.) 421, support the text. The matter embraced in section 351, Schouler, Ex'rs, is to the same effect, with a reference to Bayard v. Bank, *supra*.

But in addition to the authorities cited by defendant's counsel, they say that the case of Lowry v. Bank, *supra*, when properly understood is authority for the defendant, and Mr. Rountree in his brief quotes an extract from the opinion in that case, to wit: "Undoubtedly the mere act of permitting this stock to be transferred by one of the executors furnishes no ground for complaint against the bank, although it turns out that this executor was by the act of transfer converting the property to his own use, for an executor may sell or raise money on the property of the deceased in the regular execution of his duty, and the party dealing with him is not bound to inquire into his object, nor liable for his misapplication of the money. Such is the doctrine of the English courts, and would seem to have been the law of this state prior to Act Assem. Dec. Sess. 1843, c. 304, and the transaction now before us took place before that act went into operation. But it is equally clear that if a party dealing with an executor has at the time reasonable ground for believing that he intends to misapply the money, or is in the very transaction applying it to his private use, the party so dealing is responsible to the persons injured."

But in that part of the opinion last quoted the chief justice was considering the matter of a sale of the stock by the executor, without intending to weaken the force or to affect the correctness of the other doctrine decided in the case, and which we have been discussing; that is, that knowledge by a corporation that there is an executor is knowledge that there is a will, and also constructive knowledge that the contents of the will are known to the corporation.

After mature consideration of all the cases cited and the text in the law books to which our attention has been called, our opinion is:

First, that, where a transfer of stock of a corporation is made on its books by an executor, the corporation is fixed with a knowledge that there is a will, and is chargeable with a knowledge of its contents to the same extent as if the officers had actually read it.

Second, that, notwithstanding such knowledge of the contents of the will, the executor may, even with intent to convert to his own use

the money, sell and transfer such stock to a purchaser under the corporation's supervision, and that, even though the stock be specifically bequeathed in the will, without liability on the part of the corporation, unless it has at the time of the transfer reasonable ground to believe that the executor intends to misapply the money, or is in the very transaction applying it to his own private use.

We have arrived at the conclusion, however, that, as the corporation is fixed with the knowledge of the contents of the will when the executors transfer stock on its books, the provisions of the will in reference to the stock must be carried out in the transfer at the peril of the company in cases where the transferee is a legatee named in the will; that is, the corporation must, at the time of the transfer, ascertain whether the transfer is to a purchaser from the executor in the usual course of administration and the regular execution of his duty as executor or to a legatee named in the will.

The defendant, for another defense, takes the position that before a recovery can be had the negligence of the defendant must not only be established, but it must be shown that the transfer by the executor to Charles W. Bradley, trustee for Lucy A. Jewett, individually, was the proximate cause of the loss to the plaintiffs. Mr. Davis in his brief says: "But assuming, for the sake of the argument, that the defendant was negligent in this respect, yet it is clear that this was not the proximate cause of the loss to the plaintiffs. The title was in their trustee, and, under the law, he held it as well for them as for Lucy A. Jewett. No loss was occasioned to them by this transfer, and no injury or damage sprung from it, and, but for another and subsequent intervening cause, to wit, the act of the trustee, Charles W. Bradley, in 1869, in transferring the stock to Lucy A. Jewett, none would have occurred."

But the legal title to the stock was not in any trustee of the plaintiffs. It was in Charles W. Bradley, the trustee of Mrs. Jewett, individually. The first transfer, however, was the effective cause of the loss, and the other transfers were steps made possible by the first one, which led to the loss even of the identity of the stock or its ownership. The first transfer was wrongful, in that it was the duty of the defendant to have protected the rights of the plaintiffs, and the plaintiffs had the right, at the death of their mother, to call for a return of the stock or its value. *St. Romes v. Cotton-Press Co.*, 127 U. S. 614, 8 Sup. Ct. 1335, 32 L. Ed. 289.

The defendant further sets up the statute of limitations against the demand of the plaintiffs. We are not deciding that the plaintiffs had no right to interfere in the transfer of the stock to have it restored to its proper ownership at any time after the wrongful transfer, but they were not compelled to take action for the recovery of the stock or its



value until after the death of their mother which occurred in 1898. This action was commenced in 1899, and is not, therefore, barred by the statute of limitations.

His honor rendered judgment, upon the facts agreed, that the defendant company was liable to the plaintiffs for the value of the stock at the date of the death of Mrs. Jewett, and, by consent, that the matter be referred to a referee "to hear evidence and take testimony, and determine the value of said stock, and all other issues of law and fact raised by the pleadings not herein set out and adjudicated, and to determine what sum, if any, the plaintiffs are entitled to recover." There was no error in the judgment of the court, and the same is affirmed.

## MANAGEMENT OF CORPORATIONS—OFFICERS, DIRECTORS AND AGENTS

### I. Stockholders' Meetings <sup>1</sup>

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#### EAST v. BENNETT BROTHERS, Limited.

(Court of Chancery. L. R. [1911] 1 Ch. D. 163.)

Bennett Brothers, Limited, was incorporated in May, 1904, with a capital of £25,000. divided in 25,000 shares of £1. each, of which 10,000 were 6 per cent. cumulative preference shares and 15,000 ordinary shares.

Clause 5 of the memorandum of association (so far as material) provided that: "The company has power from time to time to increase or reduce its capital, and to issue any shares in any increased capital as ordinary, preferred, or deferred shares, and to attach to any class or classes of such shares such preferences, rights, privileges, or conditions, or to subject the same to such restrictions or limitations as may be determined by the company in general meeting, but so that no new shares shall be issued so as to rank equally with or in priority to the said cumulative preference shares, unless such issue is sanctioned by an extraordinary resolution of the holders of the cumulative preference shares present at a separate meeting of such holders specially summoned for the purpose of considering the question. So long as the capital of the company is divided into shares of various classes the rights and privileges of any class of shares shall only be modified or varied in the manner following, namely: A modification or variation of the rights of any class of shares may be effected when sanctioned by an extraordinary resolution of the holders of the shares of such class passed at a separate meeting of such holders, at which there shall be present in person or represented by proxy the holders of not less than three fourths of the issued shares of such class."

Article 46 was as follows: "So long as the capital is divided into shares of various classes, the rights and privileges of the holders of shares of each class may be varied or modified by any arrangement which is sanctioned on the one hand by an extraordinary resolution of the holders of the shares of such class, and on the other hand by a like resolution of the holders of the remaining shares of the company, each such resolution being passed at a separate meeting of

<sup>1</sup> For discussion of principles, see Clark on Corp. (3d Ed.) §§ 182-184.

the members entitled to vote thereat. Meetings of the holders of a class of shares shall be subject, so far as possible, to the same rules and provisions as the meetings of the company, but so that the quorum of the members of the class affected shall be the holders of shares of that class present in person or represented by proxy holding not less than three fourths of the issued shares of that class."

In June, 1904, the company was desirous of increasing its capital, and for that purpose of issuing an additional 10,000 6 per. cent. cumulative preference shares. At that time Joseph Bennett, Junior, was the sole holder of all the original 10,000 6 per cent. cumulative preference shares.

On June 20, 1904, an extraordinary meeting of the company (which had been duly convened) was held, at which Bennett took the chair. At that meeting a resolution was proposed by Bennett and seconded by another shareholder and carried unanimously: "That the capital of the company be increased from £25,000., divided into 10,000 6 per cent. cumulative preference shares and 15,000 ordinary shares of £1. each, to £40,000. divided into 20,000 6 per cent. cumulative preference shares and 20,000 ordinary shares of £1. each, by the creation of 10,000 6 per cent. cumulative preference shares and 5,000 ordinary shares of £1. each, such preference and ordinary shares to rank *pari passu* in all respects with the preference and ordinary respectively already existing; and that the directors be and they are hereby empowered to issue such shares at such times, to such persons, and on such terms (not being less than *par*) as they may from time to time think fit."

On the same day Bennett signed in the minute-book of the company a document in the following terms: "I, the undersigned, Joseph Bennett, Junior, hereby record my consent as the holder of all the preference shares issued by Bennett Brothers, Limited, to the increase by the company of its capital from £25,000. divided into 10,000 six per cent. cumulative preference shares and 15,000 ordinary shares of one pound each to £40,000. divided into 20,000 six per cent. cumulative preference shares and 20,000 ordinary shares of one pound each by the creation of 10,000 six per cent. cumulative preference shares and 5,000 ordinary shares of one pound each, such preference shares to rank *pari passu* in all respects with the preference shares held by me."

The resolution passed at the meeting was duly confirmed as a special resolution at a meeting of the company held on July 5, 1904.

Acting on this resolution and on the express formal consent of Bennett contained in the document signed by him, the company issued the new 10,000 6 per cent. cumulative preference shares numbered 30,001 to 40,000, both inclusive, which were now standing in the names of a number of persons specified in the plaintiff's affidavit in support of the motion.



The company now proposing to issue fresh capital, and the question arose whether the preference shares issued in 1904 were validly issued. In order to have this question determined the plaintiff, who was the holder of 400 of these shares brought the present action, on behalf of himself and all other the persons registered as holders of these preference shares, against the company, claiming by his writ (2 Q. B. D. 26) a declaration that notwithstanding the special resolution the company had never been entitled to issue any of the 10,000 preference shares, and that the same had not been duly issued to the plaintiff and the other persons whose names were entered in the share register of the company as holders thereof ([1877] W. N. 223); rescission of all contracts to take the said shares and rectification of the share register (2 Q. B. D. 29); repayment of the £1. per share paid up thereon respectively with interest; and ([1883] 25 Ch. D. 118) that the company might be restrained by injunction from paying any dividends upon the said shares or otherwise treating the plaintiff and the other persons aforesaid as members of the company in respect of the shares.

The plaintiff now moved for an interim order in the terms of the writ.

WARRINGTON, J. This is a most extraordinary case. It is a motion in an action brought by the plaintiff, on behalf of himself and all other the persons registered as holders of the preference shares in the company numbered 30,001 to 40,000, both inclusive, against the company, and the object of the motion is that the register of members of the company may be rectified by removing therefrom the names of those shareholders. The question arises in this way. [His Lordship stated the facts, and continued:]

It is suggested that the proceedings of the company were not valid, and that these shares which have been so issued and have been held for the last six years were no shares at all—were not properly issued—and on that ground the plaintiff asks to have the names of the holders of them taken off the register.

The question that I have to determine is whether what the company did was in effect, although not perhaps in terms, within the provisions of the memorandum and articles of association, and, if it was in effect though not in terms, whether there was a sufficient compliance with the memorandum and articles to render the proceedings valid. Perhaps I ought to say that the real question is not so much whether the proceedings were in effect a compliance with the memorandum and articles as whether upon the true construction of the memorandum and articles they were not really and in terms a compliance with them. The question resolves itself into this. On the construction of this particular memorandum and the particular part of it, can there be such a thing as a meeting of one shareholder? It is not a question of there being several shareholders, and one share-

holder only attending the so-called meeting, but where there is only one shareholder, so that a meeting in the sense of an assembly of persons is impossible. The object of the provisions in the memorandum is quite plain. It is to obtain, before the issue of new shares, the assent in a binding and formal manner of the person or persons whose rights are affected.

Under article 46 it is clear that if Bennett can constitute "a meeting" there is no difficulty about the quorum, because the quorum in this case is to be the holders of shares present in person (or represented by proxy) holding not less than three fourths of the issued shares of the class. In an ordinary case I think it is quite clear that a meeting must consist of more than one person. That was determined in two cases, *Sharp v. Dawes*, 2 Q. B. D. 26, which came before the Court of Appeal, and *In re Sanitary Carbon Co.* [1877] W. N. 223, which came before Sir George Jessel, M. R. In *Sharp v. Dawes*, 2 Q. B. D. 26, 29, the meeting in question was a meeting of the company. There were several shareholders in the company. A meeting was called for the purpose of making a call. One shareholder only attended the meeting. He held the proxies of other shareholders and he took the chair and passes a resolution making a call, and he proposed a vote of thanks to himself. In giving judgment in the Court of Appeal Lord Coleridge, C. J., said: "The word 'meeting' *prima facie* means a coming together of more than one person. It is, of course, possible to shew that the word 'meeting' has a meaning different from the ordinary meaning, but there is nothing here to shew this to be the case. It appears therefore to me that this call was not made at a meeting of the company within the meaning of the Act"—i. e., the Stannaries Act. In *Re Sanitary Carbon Co.* [1877] W. N. 223, the meeting again was a meeting of the company. There were several shareholders. A winding-up petition had been presented by a creditor, and it was opposed by the company on the ground that a meeting had been held at which a voluntary liquidation had been resolved upon. There again the meeting consisted of one person only, who had in his pocket the proxies of the only three other shareholders, and that person voted himself into the chair, proposed a resolution to wind up voluntarily, declared the resolution passed, and appointed a liquidator. There again the Master of the Rolls held that there was no meeting.

But now what I have to consider is whether this is not one of the cases referred to by Lord Coleridge, C. J., as one in which it may be possible to shew that the word "meeting" has a meaning different from the ordinary meaning. For that purpose I think I am entitled to see what is the object of the provision in the memorandum of association. Plainly, as I have already said, that object is that before affecting the rights of the preference shareholders it shall be necessary to obtain and record in a formal manner the assent of the preference

shareholders to that course. I think I may take it also that the persons who framed this document may have had, and must be taken to have had, in their minds the possibility at all events that this particular class of shares might fall into the hands of one person. There is nothing to prevent it in the constitution of the company. One must regard the memorandum as far as possible as providing for circumstances which in the ordinary course may arise. That being so, I think I may very fairly say that where one person only is the holder of all the shares of a particular class, and as that person cannot meet himself, or form a meeting with himself in the ordinary sense, the persons who framed this memorandum having such a position in contemplation must be taken to have used the word "meeting," not in the strict sense in which it is usually used, but as including the case of one single shareholder. There is, of course, no difficulty in treating the formally expressed assent of Bennett as a resolution. The only question is the purely technical difficulty arising from the use of the word "meeting" in the memorandum.

I think on the whole that I may give effect to obvious common sense by holding that in this particular case, where there is only one shareholder of the class, on the true construction of the memorandum, the expression "meeting" may be held to include that case. It seems to me, therefore, that the shares were validly issued and that there is therefore no necessity for the rectification of the register. I refuse the motion on that ground. I think I had better say, the Court being of opinion that the 10,000 shares in question were validly issued, no order on motion.

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### PEOPLE ex rel. CARUS v. MATTHIESSEN.

(Supreme Court of Illinois, 1915. 269 Ill. 499, 109 N. E. 1056.)

Appeal from Appellate Court, Second District, on Appeal from Circuit Court, La Salle County; Joe A. Davis, Judge.

Information in the nature of quo warranto by Mary Hegeler Carus against F. W. Matthiessen. Judgment for defendant was reversed by the Appellate Court, and defendant appeals on a certificate of importance. Affirmed.

COOKE, J. The people, on the relation of Mary Hegeler Carus, individually, and as trustee under the will of Edward C. Hegeler, deceased, appellee, filed an information in the nature of a quo warranto in the circuit court of La Salle county against the appellant, F. W. Matthiessen, calling upon him to show by what authority he was exercising the office of director of the Matthiessen & Hegeler Zinc Company, an Illinois corporation. The plea of appellant set forth his election as a director on December 18, 1913, and averred title to the office by virtue of such election. The circuit court found that the appellant had been duly and regularly elected a director of the company at a



stockholders' meeting held December 18, 1913, and a judgment of not guilty was entered. This judgment, on appeal, was reversed by the Appellate Court for the Second District, and a judgment of ouster was entered. The cause is brought here by appeal on a certificate of importance.

The sole question involved is whether the meeting of December 18, 1913, was a legal meeting of the stockholders of the corporation. It is the claim of appellee that, as the notice of the meeting required by law was not given, any action taken was invalid, while appellant contends that sufficient notice was given, and, if not, that all the stockholders were present, and it was therefore immaterial whether notice was given.

The corporation was organized in 1871 under a general incorporation act passed in 1857. Laws of 1857, p. 161. The capital stock was divided into 426 shares, and these shares were distributed among F. W. Matthiessen and Edward C. Hegeler and the members of their immediate families; the members of each family owning 213 shares. Section 6 of the act of 1857, under which the company was organized, and which became a part of the charter of the corporation, provides that an annual election of directors shall be held at such time and place as the board may designate, and a written or printed notice of such election shall be given to each stockholder personally or sent to him through the mail at least fifteen days before the day of the election, and the election shall be made by such of the stockholders as shall attend for that purpose, either in person or by proxy. It is conceded that the notice required by this section of the statute was not given of the meeting of December 18, 1913. The by-laws of the company provide that the annual meeting of the stockholders for the election of a board of four directors shall be held at the office of the company, in the city of La Salle, on December 18th of each year, excepting when that day shall fall on Sunday, in which case the meeting shall be held on the following day. The hour for holding the meeting is not fixed in the by-laws.

There was no material controversy as to the facts. It appears that the notice of the annual meeting required by the statute had never been given, but ever since the organization of the company the stockholders met by common consent some time during December 18th of each year, usually about the hour of 10 o'clock a. m., for the annual election of the board of directors. If for any reason it did not suit the convenience of either appellant or Hegeler to meet at the office of the company, the meeting, by consent of all the stockholders, was held elsewhere. The stock was held by a very limited number of persons, and the business was transacted harmoniously; two members of the Mathiessen family and two members of the Hegeler family being elected to the board of directors each year. After the death of Edward C. Hegeler 211 shares of the Hegeler stock was held by Mrs. Carus as trustee under the will of her father, one share was held by Mrs. Carus in her own right, and one share by C. B. Lihme, a son-in-law of Edward C.

Hegeler. Mrs. Carus was a director and president of the company, and Lihme was the other director representing the Hegeler interests. This was the situation on December 18, 1913. On December 17, 1913, appellant and others instituted quo warranto proceedings against Lihme to contest his right to hold the office of director in the company, and summons in that case was served on him either that evening or the next morning. Mrs. Carus and Lihme went to the office of the company in La Salle about 10 o'clock the morning of December 18, 1913. They found there present all the Matthiessen stockholders, either in person or by proxy. Lihme was much excited over the action which had been instituted against him, and he at once demanded of appellant that no election be held and no business be transacted at that time. Some of the witnesses testify that he demanded that the meeting adjourn until some time in the future, but all the testimony is to the effect that he demanded that no action be taken that day. While Lihme was engaged in making his demands a member of the Matthiessen family moved that appellant be made the chairman of the meeting, and this motion was put and declared carried. Mrs. Carus was in the same way selected as secretary of the meeting. About the time the vote was being taken on Mrs. Carus as secretary she and Lihme withdrew from the room. Mrs. Carus said nothing whatever while she was in the room, and neither she nor Lihme voted on the two motions put while they were present. It is contended that, as Lihme continued to demand that the meeting adjourn after appellant had been selected as chairman and had taken charge of the meeting, he thus participated to the extent that he is bound by the action of the meeting. Lihme did nothing but protest against the taking of any action or the transaction of any business at that time; but, be the effect of his actions what it may, Mrs. Carus said nothing and did nothing that could be construed as consenting to the holding of the meeting. Unless the provisions of the by-laws constituted sufficient notice of the annual meeting or the physical presence alone of Mrs. Carus constituted a waiver of the statutory notice, the meeting was not a legal one, and any election held thereat would be invalid. After Mrs. Carus and Lihme had departed, the election was held, and appellant was elected as one of the directors for the ensuing year.

While the trial court held, as a proposition of law, that a by-law of a corporation which names a day, but not the hour, for the holding of the annual meeting, is insufficient notice to the stockholders of the time of holding the meeting, it took the view that no stockholder can urge the invalidity of such meeting for want of notice, unless he has been injured or deprived of some substantial right by lack of notice; that, where all the stockholders are present on the day and at the place fixed in the by-laws and at an hour at which for over 20 years it was customary to hold the annual meeting, and where each stockholder knew that the annual election for directors was then about to take place, in law each stockholder had the right and opportunity to participate in

the meeting, and was not injured by lack of notice or deprived of any substantial right, and cannot urge the invalidity of the meeting on the ground of lack of notice. The court properly held that the by-laws did not constitute notice to the stockholders of the holding of the annual meeting for the election of directors. Section 6 of the act under which this company was incorporated provides that this meeting shall be held at such time and place as the board of directors may designate, and expressly requires written notice to be given the stockholders each year. Had the by-laws provided the hour at which the annual meeting should be held on each December 18th, it would have amounted to no more than the designation of the time and place of the meeting by the board, and would not take the place of the notice required by the statute. That notice is indispensable unless it is waived by all the stockholders, either expressly or by consenting to or participating in the meeting.

Did Lihme waive notice by demanding that no business be transacted, and by demanding a pledge of the chairman, after he had been selected, that the meeting do nothing but adjourn, or did Lihme and Mrs. Carus waive notice by their mere presence at the meeting? By nothing which he did or said did Lihme recognize the right of the meeting to organize or to transact business. His effort to secure a pledge from appellant, even after he had been selected by his faction as chairman, that the meeting do nothing but adjourn, amounted to no more than an offer to submit to the jurisdiction of the meeting, provided no business whatever should be transacted. His offer was not accepted, and he withdrew, protesting against the holding of the meeting.

This court has never been called upon to decide whether the mere presence of a stockholder at an annual meeting for the election of directors, with full opportunity to participate, is alone sufficient to constitute a waiver of notice and deprive him of the right to rely upon lack of notice. The text in 10 Cyc. 326, that where notice is required by statute, the meeting cannot be legally held unless the notice be explicitly given in respect of the day, hour, and place or the stockholders are all present and consenting, but if a single member having the right to be present and vote is not duly notified and is absent, or, being present, refuses to consent to the holding of the meeting, its proceedings will be void, states the correct rule and is supported by authority. This question arose in *Charter Gas Engine Co. v. Charter*, 47 Ill. App. 36, and the Appellate Court for the Second District, in an opinion written by a present member of this court, held that every stockholder had a right to be present at the annual meeting for the election of directors, and it could not be legally held until after notice of the time and place had been given in an authentic and legal mode, unless all stockholders were present and consenting, in person or by proxy. That holding is correct, and, as applied to the facts in this case, neither Mrs. Carus nor Lihme having consented to the holding of the meeting or participated in it in any way, the meeting of December 18, 1913, was not legally



held, and appellant has no valid title to the office of director of the company by virtue of any action taken at that meeting.

The judgment of the Appellate Court is affirmed.

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## II. Voting and Voting Trusts<sup>2</sup>

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### LUTHY v. REAM.

(Supreme Court of Illinois, 1915. 270 Ill. 170, 110 N. E. 373.)

DUNN, J.<sup>3</sup> \* \* \* The Peru Plow and Wheel Company is a corporation organized under the laws of Illinois, having a capital stock of \$400,000, engaged in the manufacture of plows, metal wheels, and farm implements. The complainants are the owners of 2,027 of the 4,000 shares of its stocks; Thomas Cahill being the owner of 70 shares purchased in November, 1912. In September, 1912, 41 of the stockholders, owning 2,001 shares of the stock, entered into the trust agreement in controversy. After reciting that the stockholders deemed it to their interest that all of their stock should be voted as a unit upon all questions affecting the business and management of the company, and that Henry Ream had consented to hold and vote such stock on behalf of the stockholders, the agreement provided:

"That for a valuable consideration, the receipt whereof is hereby acknowledged, and in further consideration of the mutual covenants and agreements expressed in this agreement, the stockholders hereby assign, convey, and transfer unto the trustee above named the number of shares of stock of the Peru Plow & Wheel Company, a corporation of the state of Illinois, as set opposite their respective names, to be held in trust by the said trustee for the respective stockholders by whom it is severally assigned, their personal representatives and assigns, upon the following terms and conditions:

"(1) The said trustee shall hold, control, and vote said stock as if he was the owner of all of said stock.

"(2) Said trustee shall determine how said stock shall be voted upon any question, at any time and every meeting of the stockholders.

"(3) All of said stock so held by the trustees shall be voted as a unit.

"(4) At all elections of directors of the Peru Plow & Wheel Company said trustee shall nominate three directors to be voted for at

<sup>2</sup> For discussion of principles, see Clark on Corp. (3d Ed.) §§ 185-188.

<sup>3</sup> Portions of the opinion are omitted.

such election, and said trustee shall vote all said stock held by him as a unit for each and all of the directors so nominated by him.

"(5) A vacancy in the office of trustee, as herein provided for, shall be filled in the following manner, viz.: In the event of the death, resignation, or removal, for any cause whatever, of said trustee herein, the vacancy in the office of trustee shall be filled by a majority in amount of the then holders of the stock now owned by the following stockholders (here appear the names of the signers of the agreement) parties to this agreement, as appears set opposite their respective names subscribed hereto.

"(6) Said trustee shall prepare, and issue to the stockholders, certificates showing the amount of stock held on behalf of each stockholder, respectively, and the stock so held may be divided and transferred in like manner as if it had not been assigned in trust, subject to the rights and powers of the trustee under this agreement. But no such assignment or transfer of stock shall be effective for any purpose until surrender of the certificate issued by said trustee and the issue of a new certificate to the purchaser, or assignee thereof.

"(7) No fees shall be charged by such trustee herein designated for any services performed in connection with the trust hereby created.

"(8) Said trustee shall collect and receive all dividends on the stock transferred to and held by him, and shall immediately pay over the same to the holders of trust certificates representing such stock as their respective interests appear. The trustee shall not demand or receive any compensation for receiving and paying over such dividends.

"(9) The rights, duties, and powers hereby conferred upon said trustee shall expire and wholly cease on the 1st day of September, A. D. 1922, and the trustee shall at said time assign and transfer to the persons who then hold trustee's certificates evidencing their ownership of shares of stock the amount of stock to which each holder thereof is shown by his trustee's certificate to be entitled.

"(10) Said trustee hereby accepts the trust hereby created by the above and foregoing instrument, and hereby undertakes to hold, own, and vote said stock as therein provided, and to retransfer the same on the 1st day of September, A. D. 1922, to the holders of trustee's certificates evidencing their right to receive the same. Said trustee further undertakes at all times to vote the said stock by himself or by proxy, and exercise his powers as trustee in such manner as he shall deem to be for the best interests of the stockholders of the Peru Plow & Wheel Company. Said trustee further undertakes to accept additional assignments of stock from any and all stockholders of the Peru Plow & Wheel Company, and to permit any stockholder thereof to become a subscriber to this agreement. It is expressly understood and agreed that Henry Ream, trustee herein referred to, shall not be liable, either directly or indirectly, to any person, firm, or corporation for

any loss or damage whatever occurring on account of the trusteeship, or from any act done by the said trustee in connection with the duties and trusts herein imposed upon him."

The certificates of stock of the stockholders signing the agreement were canceled, and two certificates, for 2,001 shares in the aggregate, were issued to Ream as trustee. He issued to each stockholder a trustee's certificate stating that the stockholder to whom it was issued was the owner of a certain number of shares of the capital stock of the Peru Plow & Wheel Company held by him as trustee, subject and pursuant to the terms, conditions, and stipulations of a certain agreement between him, as trustee, and certain stockholders of the said Peru Plow & Wheel Company joining in the said agreement of date September 4, 1912, a copy of which agreement was on file with the trustee, and reference was had to it as to all the terms, conditions, and requirements of the trust. The certificates were stated to be transferable only on the books of the trustee by the owner thereof in person or by attorney, upon its surrender properly indorsed, when like new certificates would be issued to the proper owner of record. On the back of each certificate was a form for its assignment.

Among the stockholders signing the agreement were Kate Cahill, John D. Cahill, and Cornelius J. Cahill, who together owned 70 shares of stock. They sold their shares to the appellant Thomas Cahill, and assigned to him their trust certificate. He presented the certificate so assigned to him to Henry Ream, who was president of the corporation, and demanded that a certificate should be issued to him by the president and secretary of the corporation for 70 shares of its capital stock; but the said Henry Ream refused to issue such certificate, and stated that said 70 shares of stock were included in the trust agreement, and that he could not and would not issue a certificate for them to Thomas Cahill for that reason. Thomas Cahill thereupon notified him that as owner of 70 shares he withdrew the same from the said trust agreement and would no longer be bound thereby, and demanded that a certificate be issued to him free from any restraint, obligation, or condition under said trust agreement; but said Henry Ream refused to issue such certificate. \* \* \*

The effect of the agreement was to place the legal title of the majority of the stock in Henry Ream, who was given the power to vote the stock for ten years upon all questions and at every meeting of the stockholders according to his own discretion, uncontrolled by the stockholders in any way. He then owned 37 shares of stock, and thus the entire control of the corporation was conferred upon the owner of less than 1 per cent. of the stock, with no power in the owners of the remaining 99 per cent. to interfere in any way. We have held that it is legitimate for the owners of a majority of the stock of a corporation to combine for the purpose of controlling the



corporation. *Faulds v. Yates*, 57 Ill. 416, 11 Am. Rep. 24; *Venner v. Chicago City Railway Co.*, 258 Ill. 523, 101 N. E. 949. In this case, however, the agreement goes much farther than any case which has heretofore arisen in this court. The voting power of the stock is absolutely separated from its ownership for a term of years, so that the real owners of the property are during that time entirely divested of its management and control, or of any participation therein. Our law contemplates that corporations shall be controlled by a majority of the stockholders, acting through directors elected by them in person or by proxy, and it has been held that a by-law of a corporation which authorizes bondholders to vote for directors at stockholders' meetings is in violation of both the constitutional and statutory provisions requiring directors to be elected by a majority of the shares of stock of the corporation. *Durkee v. People*, 155 Ill. 354, 40 N. E. 626, 46 Am. St. Rep. 340. The power to vote for directors can be exercised only by stockholders in person or by proxy, and they cannot be deprived or deprive themselves of this power. Stockholders cannot evade the duty imposed upon them by law of using their power as stockholders for the welfare of the corporation and the general interest of its stockholders. A stockholder may refuse to exercise his right to vote and participate in stockholders' meetings, but he cannot deprive himself of the power to do so. \* \* \*

A stockholder may ordinarily withdraw from a combination to control the majority of the stock of a corporation, and a contract not to transfer his shares to the opposition or vote against the combination, although it is expressly agreed that the contract shall be irrevocable. 1 *Beach on Corporations*, § 305. In section 306 of the same work it is said: "On general principles, the right to vote on stock cannot be separated from the ownership in such sense that the elective franchise shall be in one man and the entire beneficial interest in another, nor to any extent unless the circumstances take the case out of the general rule. It matters not that the end is beneficial and the motive good, because it is not always possible to ascertain objects and motives, and if such a severance were permissible it might be abused."

While the pooling of stock for the purpose of electing directors and officers and controlling the management and business of the corporation is not necessarily illegal, an agreement the purpose and effect of which are to permit the affairs of the corporation to be managed by the determination of persons other than its stockholders or by a minority of its own stockholders is invalid. *Shepaug Voting Trust Cases*, 60 Conn. 553, 24 Atl. 32, *supra*; *Kreissl v. Distilling Co. of America*, 61 N. J. Eq. 5, 47 Atl. 471; *White v. Thomas Inflatable Tire Co.*, 52 N. J. Eq. 178, 28 Atl. 75; *Warren v. Pim*, 66 N. J.

Eq. 353, 59 Atl. 773; *Bache v. Central Leather Co.*, 78 N. J. Eq. 484, 81 Atl. 571; *Morel v. Hoge*, 130 Ga. 625, 61 S. E. 487, 16 L. R. A. (N. S.) 1136, 14 Ann. Cas. 935; *Harvey v. Linville Improvement Co.*, 118 N. C. 693, 24 S. E. 489, 32 L. R. A. 265, 54 Am. St. Rep. 749; *Bridgers v. First Nat. Bank of Tarboro*, 152 N. C. 293, 67 S. E. 770, 31 L. R. A. (N. S.) 1199. The principle to be deduced from these cases is that the holders of the majority of the shares of stock in a corporation may control its management, and every person who becomes an owner of stock has a right to believe that the corporation will, and to insist that it shall, be managed by the majority; that the power to vote is inherently attached to and inseparable from the real ownership of each share, and can only be delegated by proxy, with power of revocation; that each stockholder must be free to cast his vote, whether by himself or by proxy, for the best interest of the corporation; and that each stockholder, if he desires to do so, shall have the right to exercise at each annual meeting his own judgment as to the best interest of all the stockholders, untrammelled by dictation, and unfettered by the obligation of any contract.

We held in *Venner v. Chicago City Railway Co.*, *supra*, that the election of directors under the provisions of the trust agreement there involved, in the manner therein provided, was really an election by the stockholders through their proxies, and so was not in violation of any constitutional or statutory provisions. There is no such thing as an irrevocable proxy to vote stock not coupled with any interest in the stock itself other than the right to vote it. A proxy, though stated to be irrevocable, may be revoked at any time. 1 Cook on Corporations, § 610. This contract gave to Henry Ream alone the power for ten years to elect three of the five directors of the corporation and to formulate and determine its policy, unrestrained and uninfluenced by all the other stockholders or any of them. The surrender of their duties by the stockholders is complete, and the majority have no power to direct the trustee; for he alone is to determine how the stock shall be voted, and to vote it, upon any question at any time and every meeting of the stockholders. He no longer represents the majority of the stock for 70 shares have been sold to the complainant Cahill, who has the entire beneficial interest therein. Other shares may be sold, so that before the expiration of the trust the trustee, who originally represented a majority of the stock, but now represents only a minority, may represent only his own 37 shares, and yet, if the trust agreement is to be enforced, have absolute management and control of the corporation.

In *Smith v. San Francisco & North Pacific Railroad Co.*, 115 Cal. 584, 47 Pac. 582, 35 L. R. A. 309, 56 Am. St. Rep. 119, it was held that an agreement by several purchasers of stock in a corporation to vote it as a unit for five years, in accordance with the decision

of the majority, is binding upon the parties and irrevocable. In *Carnegie Trust Co. v. Security Life Ins. Co. of America*, 111 Va. 1, 68 S. E. 412, 31 L. R. A. (N. S.) 1186, 21 Ann. Cas. 1287, the Supreme Court of Virginia held that an agreement among stockholders to place their stock in the hands of trustees for 25 years, to enable the trustees to manage the corporation, constitutes a valid trust. These cases are inconsistent with the views which we have expressed and the cases cited in support of them, but in our judgment the latter cases state the true rule. \* \* \*

Judgment reversed.

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### BRIGHTMAN v. BATES.

(Supreme Judicial Court of Massachusetts, 1900. 175 Mass. 105, 55 N. E. 809.)

Actions by Frank W. Brightman against Lot B. Bates and against James E. Dwight. Actions tried together. There was a judgment in each for plaintiff, and the cases are reported for rulings. Affirmed.

HOLMES, C. J. These are actions upon a covenant executed by the defendants. The covenant recites that 1,360 shares of the stock of the Union Street-Railway Company in New Bedford have been, or are about to be, purchased by a syndicate, under an agreement of September 4, 1894; that the plaintiff has been largely instrumental in organizing the syndicate; and that "he considers that for his services therein, in case the syndicate is formed, and the aforesaid shares purchased, he should receive for his compensation" a certain amount of stock. These recitals are followed by several covenants on the part of the defendants, and one other to give the plaintiff, in stock of the company, at \$169 a share, a commission of \$4 a share "upon the number of shares we sell to said syndicate, less the number of shares we have severally subscribed as members of said syndicate," and certain other deductions in case the compensation was not got from the syndicate. The judge before whom the case was tried found for the plaintiff, and the case is here upon a report of requests for rulings, which in various forms raise the question whether such a finding can be justified in law.

Before going further, we will dispose of one or two objections which were not the main ground of defense, and were not much pressed. The covenant was delivered to the plaintiff, and properly might be found, if not ruled, to be made to him. Beyond acceptance of the delivery to him, no other acceptance or notice of acceptance was necessary. The contract is intelligible. We cannot say that the judge was not warranted in finding that whatever efforts to get the compensation from the syndicate were necessary before coming on the defendants had been made. The 1,360 shares were subscribed for, and, although some of the subscriptions were upon stipulations, that does not affect the case, because all the stock was taken and paid for before the action was brought. We pass to the principal defense.



The syndicate referred to was formed under another written agreement, whereby the subscribers recite their desire to become members of it, to the end that control of the railway company and advantage to them may be gained, agree to take the shares set against their names at \$169 a share, and further agree after the purchase to enter into a pooling contract, whereby all the syndicate stock "shall be voted at each annual meeting for a period of not less than three years for such board of directors as shall be named" by a committee of five of the subscribers, with power to a majority of them to fill any vacancy in the committee. It is said that this agreement was illegal, and that the covenant sued upon was so directly aimed at helping to bring the unlawful arrangement about that it must fall with the other. *Barnes v. Smith*, 159 Mass. 344, 347, 34 N. E. 403; *Gibbs v. Gas Co.*, 130 U. S. 396, 9 Sup. Ct. 553, 32 L. Ed. 979.

With regard to this contention it is to be observed, in the first place, that the syndicate agreement is dated September 4th and the covenant is dated September 22d, and, as we have said, recites that the shares "have been or are about to be purchased"; that is, the sale is treated as already certain. Although one or two subscriptions seem to have been signed a day or two later, we do not perceive why the judge may not have found that the services all had been rendered at the date of the covenant, and, in view of the defendants' testimony that they never heard of those services before September 22d, why he may not have found that the covenant was a voluntary one, the legality of which would not be affected by the nature of the executed transaction which happened to furnish a motive for making it. *Gray v. Mathias*, 5 Ves. 286.

Without deciding whether, if the covenant was dependent upon the rendering of further services, it was so closely connected with the syndicate agreement as to fall if the latter cannot be sustained, we pass to the question whether the latter agreement is unlawful on its face, bearing in mind that, unless it is unlawful on its face, it has the advantage of a finding in favor of the plaintiff. In dealing with this question it does not need to be said that combination of common interests is necessary, and constantly is taking place. It is as legitimate for a majority of stockholders to combine as for other people. The fact that they expect "gain and advantage" (in the words of the syndicate agreement) to accrue to them does not make the combination unlawful. That expectation and intent would have that effect only if the gain was to be at the expense of the corporation, or in some way was intended to work a wrong to the other stockholders. No such intent appears, and, although it is impossible not to view such an arrangement with suspicion, it is also impossible to let suspicion take the place of proof.

The only serious ground of objection is the agreement that the stock "shall be voted at each annual meeting" for three years for a board of directors named by the committee. It is suggested that this was an

unlawful attempt by the contracting parties to deprive themselves in advance of their deliberative power and duty as stockholders, and to submit themselves to the dictation of five men, who, in the future, might not be even members of the corporation. Perhaps the notion upon which these suggestions are founded has been pressed somewhat further than would be warranted by more farseeing views, but we have no occasion to discuss it in this broad form. The question before us is not whether it would be possible to carry out the contract in a way which would have made the contract bad if specified in it, but whether it was impossible to carry out the contract in a way which might lawfully have been specified in advance. We put the question in this form, because there is no doubt that the subscribers might actually have done the things stipulated without giving any one a right to complain; that is to say, they might have held their stock, and voted, by previous understanding, according to the advice of the committee, as long as they chose. The question is what they might contract to do, for this is supposed to be a case where a contract to do lawful acts is unlawful.

The syndicate agreement does not specify how it is to be carried out. It contemplates the making of another contract. As the later contract is to be a pooling contract, it was possible, if not probable, that one element of the arrangement would be that the title to the stock should be given to a trustee, and this happened in fact. During the three years the stock seems to have been held by a bank. The stock was transferred to it, and was not transferred to the members of the syndicate. But it would have been possible, consistently with the terms of the syndicate agreement, that the committee who were to name the board of directors themselves should be the trustees. In that case the trustees, of course, would have voted on the stock. They, not their *cestuis que trustent*, would have been the stockholders for the time being. We know nothing in the policy of our law to prevent a majority of stockholders from transferring their stock to a trustee with unrestricted power to vote upon it. *Brown v. Steamship Co.*, 5 Blatchf. 525, 527, Fed. Cas. No. 2,025. See *Greene v. Nash*, 85 Me. 148, 26 Atl. 1114.

Supposing that the committee had been trustees, what would the syndicate agreement have amounted to then? Merely an agreement by each of the trustees to vote as they should jointly agree to vote, and an agreement by the subscribers not to demand back their shares for three years. The latter term certainly is not illegal, whether valid or not. A stockholder has a right to put his shares in trust, whatever his motive. If the trust is an active one, he cannot terminate it at will; and the attempt to cut himself off by contract, instead of by the imposition of duties, from ending it, certainly is not enough to poison the covenant with the plaintiff. See *Williams v. Montgomery*, 148 N. Y. 519, 525, 43 N. E. 57. It might be held that the duty of voting incident to the legal title made such a trust an active one in

all cases. As to the arrangement for the trustees uniting to elect their candidates, the decisions of other states show that such arrangements have been upheld, and we do not think that it needs argument to prove that they are lawful. If stockholders want to make their power felt, they must unite. There is no reason why a majority should not agree to keep together. *Faulds v. Yates*, 57 Ill. 416, 11 Am. Rep. 24; *Smith v. Railway Co.*, 115 Cal. 584, 47 Pac. 582, 35 L. R. A. 309, 56 Am. St. Rep. 119; *Havemeyer v. Havemeyer*, 43 N. Y. Super. Ct. 506, 512, 513, affirmed, according to Beach, Priv. Corp. § 504, note 6, and *Fisher v. Bush*, 35 Hun, 641, in 86 N. Y. 618. See *Brown v. Steamship Co.*, 5 Blatchf. 525, 527, Fed. Cas. No. 2,025.

We have considered such decisions elsewhere as have been called to our attention or found by us. Few of them are by courts of final resort. Nothing that we have found in them satisfied us that the judge below was not warranted in finding for the plaintiff.

Judgment affirmed.

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### III. Relation between Officers and Corporation <sup>4</sup>

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#### CRITTENDEN & COWLER CO. v. COWLER.

(Supreme Court of New York, Appellate Division, Third Department, 1901.  
66 App. Div. 95, 72 N. Y. Supp. 702.)

Appeal from Special Term.

Suit for an injunction by the Crittenden & Cowler Company against Benjamin S. Cowler. From an order granting an injunction pendente lite restraining the defendant from assigning, surrendering, or disposing of a lease, and from taking any proceedings thereunder to eject plaintiff from the leased premises, and from in any way interfering with plaintiff's enjoyment of the full benefit of such lease as though made to it as lessee, the defendant appeals. Reversed.

KELLOGG, J. It appears from the moving papers: That plaintiff is a domestic corporation engaged in the business of selling at retail stationery, wall paper, etc., in Glens Falls, N. Y. That the lease of the store it occupied and did business at expired May 1, 1901. That defendant and one James W. Barber were at that time, and for some months prior thereto, the sole directors of said corporation. That Mr. Barber had control of the majority of stock of said corporation. That for some time prior to May 1, 1901, a feud existed between these directors. That Mr. Barber threatened to deprive defendant of the management of the corporate business. That Mr. Barber first applied to the landlord for a new lease running to the corporation; the cor-

<sup>4</sup> For discussion of principles, see Clark on Corp. (3d Ed.) § 200.



poration never having a lease from the landlord, but having occupied under a lease assigned to it by a former lessee. That, soon after the application for a lease made by Mr. Barber, the defendant applied for a lease in his own name. Thereupon the landlord made a journey from his residence in Poughkeepsie to Glens Falls to investigate the situation. At Glens Falls the landlord had a meeting, at which was represented the defendant, Mr. Barber, and all the stockholders of the corporation. The propriety or wisdom of leasing the premises to the corporation seems to have been fully considered at that time by the landlord, and he seems to have reached the determination not to lease to the corporation. He refused its application for a lease, saying "that he had never recognized the corporation as his tenant, and that he would not recognize it now." The lease in question was thereafter, and upon the same day (April 29, 1901), made with defendant. The lease covenants against subletting and against assigning the lease of the premises called the "Store." A bond with surety was exacted of the defendant by the landlord, and was furnished for the faithful performance of all the covenants of the lease.

This case presents material facts which distinguish the case from any reported case brought to our attention. Here there was no secret leasing, no act done "behind the back." Here we have a positive refusal on the part of the landlord to accept the corporation as a tenant. This refusal, after application made and considered, disposed of and cut off that "expectancy" which is declared by some authorities to run with every lease,—the expectancy of a renewal. This has been deemed a species of property in the lessee, and a copartner or one standing in any fiduciary capacity is not permitted to profit by taking a renewal in his own name while this expectancy exists. But the rule ceases to operate when such expectancy no longer exists. It will hardly be claimed that a landlord may not exercise his own discretion in the selection of a tenant. He may or may not renew, as he chooses. When once he has declared against renewal, the tenant, then in occupation, has no more an expectancy which can be dealt with. Whoever thereafter leases does the tenant no injury, and takes from him no property or property rights. I see no reason in law or equity in excluding a copartner or a director in a corporation from dealing with the landlord in respect to the premises after a renewal to the occupying tenant has been refused by the landlord. The terms of the lease in question are presumably the terms insisted upon by the landlord. As between the landlord and this defendant the lease is binding. There can be no subletting and no assigning without the landlord's consent. This would seem to place the interference by the courts to force a subletting to the plaintiff, and to make a tenant for the landlord without his consent, as quite beyond its powers. Under the facts in this case, whatever redress the plaintiff may have, it does not seem to me that it can have the right to occupy these premises as tenant without first getting permission of the landlord. Therefore, to en-

join the defendant against performance of the letter of his lease, and enjoining interference in the occupancy by the corporation of these premises, is to install a tenant in spite of the covenants of the lease, and to interfere with contract relations in a way unprecedented and unwarranted by the facts here disclosed.

The order should be reversed, with \$10 costs and disbursements, and motion for injunction denied, with \$10 costs. All concur.

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#### IV. Liability of Officers and Directors to the Corporation <sup>5</sup>

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##### GIBBONS v. ANDERSON.

(Circuit Court of United States, 1897. 80 Fed. 345.)

SEVERENS, J.<sup>6</sup> The bill in this case was filed by the complainant, as receiver of the City National Bank of Greenville, to establish the liability of the defendants, Foster and Anderson, who were directors of the bank, for negligence in the performance of their duties as such, which it is alleged has resulted in a heavy loss to the bank and its creditors. The bank was organized April 28, 1884, with a capital stock of \$50,000. It was suspended on the 22d day of June, 1893. The complainant was appointed receiver thereof by the comptroller of the currency five days later, and on July 1, 1893, entered upon the discharge of his duties. The total liability of the bank to its creditors at the time of its failure was \$237,733. The nominal value of its assets was about \$326,000, but the total net amount which the receiver has been able to realize from the assets is only about \$40,000. This result is certainly a very startling one, and the enormous loss in the liquidation of the bank's assets calls for an inquiry for its causes. And they are not far to seek. The defendants were members of the board of directors from its organization to the date of its suspension. Le Roy Moore was another director, and, either in the capacity of cashier or president, was its managing officer during the whole of the bank's operations. If during part of the time another person was cashier, he was only nominally such. Moore dominated the bank, and exercised the functions of cashier. Upon investigation it turns out that substantially from the beginning Moore employed the bank for the promotion of his own business enterprises, and, to a steadily increasing amount, has in one way and another diverted its funds to his own use, to the extent that at the date of the suspension of the bank he was indebted to the bank upon paper of which he was the maker in the sum of

<sup>5</sup> For discussion of principles, see Clark on Corp. (3d Ed.) §§ 203-205.

<sup>6</sup> A portion of the opinion is omitted.

\$36,263.63, and as indorser in his own name in the sum of \$44,819.59. He was also liable as indorser under the name of Le Roy Moore & Co. in the sum of \$17,419.97. No other person than Le Roy Moore was liable for these indorsements of Le Roy Moore & Co.; the other member having long since been discharged by the renewal of paper and the extension of credit without his knowledge,—that firm having been dissolved in 1887, and the liabilities thereof assumed by Moore. There was also in the bank at the time of its suspension, representing part of its assets, paper upon which the Stanwood Manufacturing Company was maker to the amount of \$8,750, and upon which it was indorser, \$67,748.54, amounting in all to \$76,498.54. This Stanwood Manufacturing Company was a business concern of which Moore was the owner, with a trifling exception. He owned 2,400 of the 2,500 shares of \$10 each, and, so far as appears, only 20 other shares were taken. The books of the company show that \$15,000 only of its capital stock were paid in, and this by Le Roy Moore's individual promissory notes, upon which he never made any payment. The bank had a chattel mortgage on all its property, and the sum of \$3,500 was the sum realized out of the sale of that property under this mortgage. Over \$63,000 of paper held by the bank, upon which the Stanwood Manufacturing Company was indorser, consisted of accommodation notes made by the employes about the factory of the Stanwood Manufacturing Company, and was worthless. This paper was all unloaded upon the bank by Moore in the prosecution of his own enterprises, and operated practically as a credit to himself. For a number of years prior to the suspension of the bank he was a borrower from it, either upon his own name, or under a guise so thin as to be transparent, to an amount grossly in excess of the legal limit. The comptroller in his letter of October 14, 1892, states that at the last examination he was directly indebted to the bank in the sum of \$29,565. In all these ways, direct and indirect, Moore converted the assets of the bank to his own use, and in the end it appears that for all these large sums which Moore had obtained, and which were represented by paper which he had employed for that purpose, amounting to \$172,768.88, only a very little can be realized. Moore made a trust deed of all his property to secure the debts he owed to the bank, out of which not more than \$12,000 to \$15,000 can be realized. This is the result, not of a single fraud, nor of a group of contemporaneous frauds, practiced by Moore, but, as already stated, it is the consequence of malversation of the funds of the bank from about the beginning of its history. It is needless to go into detail. The books of the bank show that he was going deeper and deeper into the funds of the bank, and, under one cover or another, converted of its assets more than three times the amount of its capital stock.

The defendants, who were directors all this time, say that they were ignorant of anything wrong in the affairs of the bank until their eyes were opened to the facts by its failure. Greenville is a small place,



of only about 3,000 inhabitants, and the defendants resided there. The volume of the business of the bank was comparatively small—certainly not so large but that the most cursory examination of the general features of its business by any one having ordinary business intelligence would have disclosed the truth. It is contended by the directors that they did not in fact know how Moore was carrying the substance out of it, and it is the more charitable view to take their conduct to the extent that supine negligence is more easily excused than active fraud. There is in the record the testimony of witnesses stating that at the time of the failure of the bank these defendants declared that they trusted all to the president, and that they knew but little of the bank's affairs, relying as they did upon their confidence in the management. But what else can be said than that, if they had notice of the facts, they were culpable, or that, if they did not know them, they were grossly negligent and inattentive to their duties? The testimony convinces me that the latter is the fact, and that their negligence and lack of interest was so profound that not even the disclosures and the warning contained in the letter of the comptroller of October 14, 1892, and which, pursuant to his request, was brought to their attention, aroused them from the stupor which beset them; for the situation was in no wise redeemed, and grew steadily worse without the moving of a hand by the directors to save it. From the time of their election the board of directors seems to have slumbered over the affairs of the bank while its managing officer was plundering it of all that it owned, and much that belonged to others. Once in a while there seems to have been some faint consciousness, but nothing which indicates any activity. But they say, and have called witnesses to prove, that acting in accord with the usage and custom of national banks, and having called into the management a person in whom they had entire confidence, which was justified by his reputation, and committed the affairs of the bank to him, they were not bound to have doubt and distrust of his correct dealing until something occurred which should arouse suspicion. And this is their defense.

The learned counsel for the defendants puts the question thus: "Whether a director in a national bank is individually liable for loss to the bank accruing through another director, viz., its president, when such mismanagement was not known to or participated in by the directors sought to be charged." Or, in another form: "Whether an individual director in a national bank is liable in his individual capacity for all losses occasioned by the mismanagement of the bank's affairs by a trusted officer through the neglect of the board of directors to meet and examine into the affairs of the bank."

These questions present in the most favorable light for the defendants what is undoubtedly the substance of the inquiry upon the facts which existed in this case, and which is, in short, this: Whether the duty of the board of directors is discharged by the selection of officers of good reputation for ability and integrity, and then leaving the af-

fairs of the bank without any other supervision or examination than mere inquiry of the officer, and relying upon his statements until some cause for suspicion attracts their attention. Section 9 of the national banking act, being section 5147 of the Revised Statutes, provides that: "Each director, when appointed or elected, shall take an oath that he will, so far as the duty devolves on him, diligently and honestly administer the affairs of such association."

And by section 5145 it is declared that the affairs of such association shall be managed by not less than five directors. The oath which the director is required to take, that he will diligently and honestly administer the affairs of such association, indicates the scope of his obligation. The management of the bank is cast upon the board of directors. The duty of managing and administering the affairs of the bank by the board of directors has been differently construed in decisions bearing upon this subject, but it is not necessary for me to analyze the cases, or to reconcile their apparent differences. Some of them have gone to a length which in my opinion is extremely dangerous to the public safety, and, if generally applied, would make these banking associations, which were designed to supply the people of the country with financial institutions hedged about with security on which their confidence might securely rest, the objects of doubt and distrust. The rule of decision by which my judgment in the present case must be guided is laid down in the case of *Briggs v. Spaulding*, 141 U. S. 132, 11 Sup. Ct. 924, 35 L. Ed. 662. Much of the discussion in that case was devoted to the consideration of the special circumstances upon which rested the charges made against the several directors. Those circumstances have little or no resemblance to those of the present case, and not much aid is afforded by that part of the discussion; for, as the court in that case observed, each case must stand upon its own facts. The directors in that case were held to be excusable.

One very important and noticeable difference between that case and this is in the fact that the question there was narrowed down to one of fact, as to whether the defendants were fairly liable for not preventing loss by putting the bank into liquidation within 90 days after they became directors, the previous condition of the bank being admitted to have been good, whereas in the present case the defendants' neglect runs through quite a number of years. But the court laid down certain general rules by which the obligation of directors of national banks is to be tested; that is to say, they declare what is the minimum of that obligation. Chief Justice Fuller, delivering the opinion of the court, said: "We hold that directors must exercise ordinary care and prudence in the administration of the affairs of a bank, and that this includes something more than officiating as figureheads. They are entitled, under the law, to commit the banking business, as defined, to their duly-authorized officers, but this does not absolve them from the duty of reasonable supervision; nor ought they to be per-

mitted to be shielded from liability because of want of knowledge of wrongdoing, if that ignorance is the result of gross inattention."

In my opinion, it does not meet the requirements of this statement of the law that directors may confide the management of the operations of the bank to a trusted officer, and then repose upon their confidence in his right conduct, without making examination themselves, or relying upon his answers to general questions put to him with regard to the status of the affairs of the bank. To begin with, it is to be assumed in every case that the directors have not selected any other than a man of good reputation for capacity and integrity. Any other idea assumes that they have been guilty at the outset of a glaring fault. Further, it is a well-known fact that a large proportion of the disasters which befall banking institutions come from the malfeasance of just such men, and it would be manifest to everybody that only a satisfactory and quieting reply would be made by the official who has any reason for concealment. Again, what are the duties of management that are committed to the cashier, or the officer standing in his place? They are those which relate to the details of the business, to the conduct of particular transactions. Even in respect of those, his duties are conjoint with those of the board of directors. In large affairs it is his duty to confer with the board. In questions of doubt and difficulty, and where there is time for consultation, it is his duty to seek their advice and direction. It is his duty to look after the details of the office business, and generally to conduct its ordinary operations. It is the right and duty of the board to maintain a supervision of the affairs of the bank; to have a general knowledge of the manner in which its business is conducted, and of the character of that business; and to have at least such a degree of intimacy with its affairs as to know to whom, and upon what security, its large lines of credit are given; and generally to know of, and give direction with regard to, the important and general affairs of the bank, of which the cashier executes the details. They are not expected to watch the routine of every day's business, or observe the particular state of the accounts, unless there is special reason; nor are they to be held responsible for any sudden and unforeseen dereliction of executive officers, or other accidents which there was no reason to apprehend. The duties of the board and of the cashier are correlative. One side are those of an executive nature, which relate mainly to the details. On the other are those of an administrative character, which relate to direction and supervision; and supervision is as necessarily incumbent upon the board as direction, unless the affairs of banks are to be left entirely to the trustworthiness of cashiers.

Doubtless there are many matters which stand on middle ground, and where it may be difficult to fix the responsibility, but I think there is no such difficulty here. The idea which seems to prevail in some quarters, that a director is chosen because he is a man of good standing and character, and on that account will give reputation to



the bank, and that his only office is to delegate to some other person the management of its affairs, and rest on that until his suspicion is aroused, which generally does not happen until the mischief is done, cannot be accepted as sound. It is sometimes suggested, in effect, that, if larger responsibilities are devolved upon directors, few men would be willing to risk their character and means by taking such an office; but congress had some substantial purpose when, in addition to the provision for executive officers, it further provided for a board of directors to manage the bank and administer its affairs. The stockholders might elect a cashier, and a president as well. The banks themselves are prone to state, and hold out to the public, who compose their boards of directors. The idea is not to be tolerated that they serve as merely gilded ornaments of the institution, to enhance its attractiveness, or that their reputations should be used as a lure to customers. What the public suppose, and have the right to suppose, is that those men have been selected by reason of their high character for integrity, their sound judgment, and their capacity for conducting the affairs of the bank safely and securely. The public act on this presumption, and trust their property with the bank in the confidence that the directors will discharge a substantial duty. How long would any national bank have the confidence of depositors or other creditors if it were given out that these directors whose names so often stand at the head of its business cards and advertisements, and who are always used as makeweights in its solicitations for business, would only select a cashier, and surrender the management to him? It is safe to say such an institution would be shunned and could not endure. It is inconsistent with the purpose and policy of the banking act that its vital interests should be committed to one man, without oversight and control.

Recurring to the present case, it is clear that unless the board of directors is to be absolved upon the theory that they were justified in committing the affairs of the bank to Moore, and relying upon his good conduct, and his answers to the perfunctory questions which were occasionally put to him, until they were brought to the facts by the collapse of the bank upon the first prick of a financial stringency such as came upon the country in the summer of 1893, they must be held liable. It is with sincere commiseration and regret that the court feels compelled to reach this conclusion, in view of the consequence which must follow to these directors. But there is another side to this matter. The court cannot ignore the rights and interests of the depositors and others who have trustfully confided their money to the bank, and who now find that it was run through a shell into the hands of Moore, while the defendants turned their heads away, and failed to give them the protection which a proper discharge of their duties would have afforded. The records of the board of directors make a sorry showing, when put in contrast with the financial history of the bank. The entries are few, at long intervals, and are almost wholly limited to the

election of directors and the declaration of dividends. They are feebly supplemented by the oral testimony of the defendants, which tends only to show that individual inquiries were occasionally made by them, of a comparatively superficial character. There was no examination of the books; at least none of any value. If there had been such examination by a fairly intelligent man, such as a director promises he is, the condition of things would have been seen. It is not irreconcilable with what they declared, when the bank failed, with respect to their knowledge of its affairs, and with what I must believe was substantially the truth of the matter. It may be conceded that the members of the board were not responsible for the malfeasance or nonfeasance of their associates, where the fault of the others was not known to them, and they were helpless to prevent the consequences; but in the present case the charge of negligence rests upon the whole board, and there is nothing to show that the defendants took any steps to retrieve the consequences of the joint negligence. If the defendants had been able to show that they themselves had done what they could to induce the board to attend to its duty, a different case would be presented. \* \* \*

Decree entered in conformity with opinion.

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### CHILDS v. WHITE.

(Supreme Court of New York, Appellate Division, First Department, 1913.  
158 App. Div. 1, 142 N. Y. Supp. 732.)

Appeal from Trial Term, New York County.

Action by William H. Childs against H. Kirke White. From a judgment entered on a directed verdict for defendant, plaintiff appeals. Reversed, and new trial granted.

HOTCHKISS, J. In October, 1910, plaintiff purchased from the domestic business corporation of White, Van Glahn & Co. \$50,000 of its preferred stock at par. In May, 1911, the company was adjudged a bankrupt. By this action plaintiff seeks to recover his loss from defendant, whom he alleges was continuously a director of the company from its organization in December, 1908, until its failure. In brief, the negligence alleged in the complaint, evidence tending to prove which was given in plaintiff's behalf at the trial, was that defendant, knowing the company to be insolvent at its inception, became a director to facilitate the sale of the company's preferred stock by giving to the company the benefit of his name and his reputation for wealth and business success; that defendant was negligent in the performance of his duties as director, and permitted one Van Glahn to manage all of the company's affairs, including the sale of said stock, which sale was accomplished by false circulars, false reports to one or more commercial agencies, the payment of unearned dividends (see Ottinger v. Bennett, 203 N. Y. 554, 96 N. E. 1123, reversing s. c. on opinion Miller, J.,

144 App. Div. 525, 129 N. Y. Supp. 819), false oral statements made by Van Glahn personally, and by other deceitful means, of some of which acts defendant had actual knowledge as to others he had notice of facts which should have put him on inquiry, and that as to all, if defendant had conducted himself with reasonable prudence and had he not practically abdicated all and failed to perform any of his duties as director, he would have known the circumstances under which the stock was being sold, and plaintiff would not have been led into the investment and loss of his money.

The respondent argues that such an action will not lie; that there is no "privity" between the plaintiff, a stockholder, and defendant, a director. Of privity in a strict sense of course, there is none. Nor is any necessary. But two elements are ordinarily necessary to sustain an action for negligence—a violation of duty owing by one to another or to the public, followed by such an injury as is the natural consequence of the negligent act, or which might reasonably have been anticipated to result therefrom (per Andrews, C. J., *Knox v. Eden Musee Am. Co.*, 148 N. Y. 441, 461, 462, 42 N. E. 988, 31 L. R. A. 779, 51 Am. St. Rep. 700).

That directors of corporations owe a certain measure of duty not only to existing stockholders, but as well to those from whom the corporation may solicit subscriptions for its stock or securities, and that they are in that behalf bound to use some degree of both diligence and care in the performance of such duties as properly pertain to their office, and are liable for negligence in failing so to do, is a proposition too well established to be now open to dispute. What is due diligence and care varies with the circumstances of each case, and it is impossible to formulate precisely general rules which will cover all states of fact. But that directors are bound to use a reasonable degree of care in the performance of those acts, which, under the circumstances, prudence would fairly seem to require them to perform, is, in the light of the authorities, a lenient statement of the rule of law affecting this subject. See *Campbell v. Watson*, 62 N. J. Eq. 396, 426, 50 Atl. 120 et seq. The classes of actions in which the duties of directors have been defined have commonly been those based upon deceit or breach of trust. Some have arisen upon rights of action originally accruing to the corporation, but which have been prosecuted in its behalf by stockholders or by receivers; others have been actions brought by stockholders or creditors directly to their own use. But the circumstances under which the action must be pursued in the right of the corporation and those under which it may be brought for the use of the individual plaintiff (see *Niles v. N. Y. C. & H. R. R. Co.*, 176 N. Y. 119, 123, 124, 68 N. E. 142) suggest no distinction so far as the duties of a director are concerned.

While the legal relation which directors occupy toward the foregoing several classes of plaintiffs may not be identical (*Briggs v.*



Spaulding, 141 U. S. 132, 148, 11 Sup. Ct. 924, 35 L. Ed. 662; Dykman v. Keeney, 154 N. Y. 483, 491, 48 N. E. 984), and although the measure of service and attention owing by directors is not the same in all kinds of corporations, there is to be found in many of the reported cases language which upon principle is clearly applicable to an action for negligence against one in the situation of this defendant. Thus in *Hun v. Cary*, 82 N. Y. 65, 71, 37 Am. Rep. 546, it was said: "When one deposits money in a savings bank, or takes stock in a corporation, thus divesting himself of the immediate control of his property, he expects, and has the right to expect, that the trustees or directors, who are chosen to take his place in the management and control of his property, will exercise ordinary care and prudence in the trusts committed to them—the same degree of care and prudence that men prompted by self-interest generally exercise in their own affairs. When one voluntarily takes the position of trustee or director of a corporation, good faith, exact justice, and public policy unite in requiring of him such a degree of care and prudence, and it is a gross breach of duty—*crassa negligentia*—not to bestow them."

In *McClure v. Wilson*, 70 App. Div. 149, 153, 75 N. Y. Supp. 212, 215, in which a receiver of a co-operative life insurance company sought to recover from a director moneys received to the use of the corporation, we said: "As a director he was chargeable with such knowledge as he gained in that capacity or might have learned by the exercise of reasonable care. He could not blindly shut his eyes to what was transpiring about him and shelter himself behind the claim that he was merely acting in the interest of a friend, and knew nothing of what he was doing."

Upon abundant authority, in *People v. Equitable Life Assurance Society*, 124 App. Div. 714, 731, 109 N. Y. Supp. 453, the same principle of imputed knowledge and responsibility for nonfeasance and acts suffered to be done because of inattention and lack of care was applied by this court in a statutory action against directors for loss occurring through neglect of duty. The recent case of *Rives v. Bartlett*, 156 App. Div. 552, 141 N. Y. Supp. 561 (decided May 9th, 1913), was an action of deceit against directors for inducing plaintiff to purchase stock of their corporation. If the views there expressed with respect to the duty and responsibility of directors are applicable in an action of deceit, they certainly apply to the present case. In short, the books are full of cases defining and applying the obligations under which directors of various classes of corporations rest, including their obligations to prospective as well as existing stockholders, and prescribing rules of conduct which it cannot be doubted were violated by this respondent, if he were guilty of all or some of the acts alleged, and to which the evidence of the appellant was directed.

In view of the fact that there must be a new trial, we refrain from commenting upon the force or effect of the evidence offered at the trial

further than to say that we think it was such as entitled plaintiff to have the questions of fact submitted to the jury, and that the direction of a verdict in defendant's favor was error.

The judgment should be reversed and a new trial granted, with costs to appellant to abide the event.

INGRAHAM, P. J., and LAUGHLIN and SCOTT, JJ., concur. DOWLING, J., dissents.

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## V. Liability of Corporation for Torts of Officers and Agents<sup>7</sup>

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### NOWACK v. METROPOLITAN ST. RY. CO.

(Court of Appeals of New York, 1901. 166 N. Y. 433, 60 N. E. 32, 54 L. R. A. 592, 82 Am. St. Rep. 691.)

Appeal from supreme court, appellate division, First department.

Action by Joseph Nowack, by Barnett Nowack, his guardian ad litem, against the Metropolitan Street-Railway Company. From a judgment of the appellate division (54 App. Div. 302, 66 N. Y. Supp. 533) affirming a judgment for defendant, plaintiff appeals. Reversed.

This action was brought to recover damages alleged to have been sustained by the plaintiff, when a lad of 12 years, through the negligence of the defendant in running over him with one of its horse cars, and inflicting injuries which resulted in the loss of his right leg. Upon the trial the theory of the plaintiff was that he started to cross East Houston street, in the city of New York, when a horse car of the defendant was approaching from the west, about 75 feet away. He had about 16 feet to go in order to get entirely across the track. Going southerly in a diagonal direction, in order to reach a point further east on the opposite side of the street, where he was called by an errand, his back was partly towards the approaching car. He thought he had time to cross in safety, but after crossing the north rail he was knocked down by one of the horses on the south side of the track and run over by the car. The horses were galloping at full speed under the whip of the driver, and after running over the plaintiff the car went nearly three blocks before it stopped. The theory of the defendant was that the plaintiff was not in front of the horses at any time, and was not crossing the street, but was trying to catch on to the car near the middle, and that after several efforts he fell under the car, the rear wheels of which passed over him.

The conflict in the evidence was irreconcilable, for several witnesses were called to sustain the theory of either party. Among them, on the

<sup>7</sup> For discussion of principles, see Clark on Corp. (3d Ed.) §§ 207-209.

part of the plaintiff, one Klein was sworn, who testified that he was standing on the front platform with the driver, who was whipping his horses, which were running at full speed. He first saw the plaintiff when he was from 12 to 15 feet in front of the horses, between the two rails, and about to cross the south rail. He told the driver to look out for the boy, but the reply was, in substance, "Mind your own business." On the cross-examination he was asked if before the former trial of the action he tried to induce a woman to swear that she saw him on the front platform and that she refused, but he denied it. On the redirect examination he testified that he knew one Kaufmann, who had been to his house five or six times during the week then past; the first time being on Saturday, a week before. He was asked to state what Kaufmann said to him on that day, but it was excluded. The witness was then withdrawn, and Kaufmann, being put upon the stand by the plaintiff, testified that he was employed by the defendant as an investigator; that his duties were "to see to the witnesses and take statements and to interview witnesses,"—those who "expect and those who are" witnesses; and that he had been acting in this case for the defendant. The plaintiff thereupon resumed the examination of Mr. Klein, and asked him to state the conversation that he had with Kaufmann on the Saturday in question; but the defendant's objection as incompetent, immaterial, and irrelevant was sustained, and the plaintiff excepted. After the witness had testified that he had a conversation with Kaufmann on the occasion mentioned in reference to the testimony that he was to give upon the trial, he was asked these questions: "What conversation did he have with you in reference to the testimony you were to give upon the trial of this action? Did Harry Kaufmann make any offer to you of money or any other thing in reference to the testimony you were to give upon the trial of this action?" Each of these questions was objected to upon the ground above stated, the objections were sustained, and the plaintiff excepted separately to each ruling.

VANN, J. Evidence tending to show that a party to an action tried to bribe a witness to give false testimony in his favor, although collateral to the issues, is competent as an admission by acts and conduct that his case is weak and his evidence dishonest. It is somewhat like an attempt by a prisoner to escape before trial or to prove a false alibi, or by a merchant to make way with his books of account, except that it goes further than some of these instances; for, in addition to reflecting on the case, it reflects upon the evidence on that side of the controversy. "Where it appears that on one side there has been forgery or fraud in some material parts of the evidence, and they are discovered to be the contrivance of a party to the proceeding, it affords a presumption against the whole of the evidence on that side of the question, and has the effect of gaining a more ready admission to the evidence of the other party." 1 Phil. Ev. (C. & H. Notes) 627. It is not conclusive, even when believed by the jury, because a party may think he has a bad case when in fact he has a good one, but it tends to discredit his



witnesses and to cast doubt upon his position. It is for the consideration of the jury, after ample opportunity for explanation and denial, under proper instructions to prevent them from giving undue attention to the collateral matter to the detriment of the main issue. The leading authority in support of such evidence is an English case, decided after careful argument by counsel and upon full discussion by the judges. *Moriarty v. Railway Co.*, L. R. [5 Q. B.] 314. It is also sustained by the cases in this state relating to the subject, some with and some without discussion. *Cruikshank v. Gordon*, 118 N. Y. 178, 187, 23 N. E. 457; *Gray v. Railway Co.*, 165 N. Y. 457, 459, 59 N. E. 262; *Mather v. Parsons*, 32 Hun, 338; *Gulerette v. McKinley*, 27 Hun, 320; *Adams v. People*, 9 Hun, 89. It is received even in criminal actions. *People v. Rathbun*, 21 Wend. 509; *Gardiner v. People*, 6 Parker, Cr. R. 155, 205; *Donohue v. People*, 56 N. Y. 208. The same rule prevails in other states, without exception, so far as we have been able to discover. *Egan v. Bowker*, 5 Allen (Mass.) 449; *State v. Nocton*, 121 Mo. 537, 551, 26 S. W. 551; *Heslop v. Heslop*, 82 Pa. 537, 539; *Snell v. Bray*, 56 Wis. 156, 162, 14 N. W. 14; *Lyons v. Lawrence*, 12 Ill. App. 531; *People v. Marion*, 29 Mich. 31; *Com. v. Webster*, 5 Cush. (Mass.) 295, 316, 52 Am. Dec. 711. The elementary writers sanction it, some notwithstanding they concede it to be collateral, and others upon the ground that, as it relates to good faith or the intent of a party, it is a material fact, and has a direct bearing on the issue. 1 *Tayl. Ev.* (9th Ed.) 242; 1 *Greenl.* (15th Ed.) § 196; *Wheat. Ev.* § 1265; 1 *Starkie, Ev.* 437; 11 *Am. & Eng. Enc. Law* (2d Ed.) 503.

It is claimed, however, that such evidence is not admissible against a corporation without proof of some corporate act expressly authorizing an agent to tamper with witnesses. This is equivalent to claiming that such evidence cannot be received against corporations at all, because, in the nature of things, proof of express authority would be impossible. A corporation can act only through agents, and where a branch of its business, whether broad or narrow, is intrusted to an agent, without any restriction, whatever he does which directly relates to that part of the corporate business, and tends to promote it, is binding upon the corporation. Under such circumstances he has control of the method of action, and that which he does, whether morally right or wrong, within the general scope of the matter intrusted to him, in legal effect is done by the corporation itself. Having authority to accomplish a certain result, with no limitation as to the means to be employed, his acts, so far as they directly contribute to that result, even if unlawful, are corporate acts. They are done for the corporation by an agent clothed with general authority to effect a certain purpose, which they aid in attaining. Any admission made by him through acts done to carry on his branch of the business, and which reasonably tend to advance it, is regarded in law as made by the corporate body which authorized him to act for it with reference to the subject of his employment. *Kaufmann* was employed to look up and "see to" witnesses for

the defendant, so as to enable it to defeat the plaintiff's claim, among others. He was to find witnesses, if possible, who would swear to such a state of facts as would prevent a recovery against the defendant. The method of doing this was left to his judgment and discretion. If he adopted a method not contemplated by the defendant, still it is responsible for what he did, in the line of his employment, to promote its interest. In order to promote its interest, he saw fit, as we must now assume, to use the power intrusted to him by trying to bribe the most important witness for the plaintiff to testify falsely in favor of the defendant. He was employed "to see to the witnesses," and this was his manner of seeing to them. He was to procure evidence, the method not being specified, and he tried to get it by an unlawful method. The subject was left to his judgment, and he acted according to his judgment. The scope of the business intrusted to him included whatever he thought best to do in order to get the right kind of witnesses. He was not working for himself, but for the defendant; and, as he represented it with reference to the subject of witnesses, his conduct not only tended to show that its case was weak, for witnesses are not bribed unless it is thought necessary, but to cast a doubt upon the testimony of the other witnesses who were looked up by him and sworn by the defendant. It indicated, as the result of his investigation for the defendant, that honest witnesses could not be procured who would swear to a defense. If he could not make a mere admission as such, he could do an act which had the effect of an admission. His declarations *dum fervet opus* were acts. Those acts, if shown, would have reflected upon the integrity of the defendant's case as presented in court through the medium of witnesses, and would have tended to prevent the verdict which was rendered in its favor. They would have afforded "a presumption against the whole of the evidence" for the defendant, which has served it so well. It has had the benefit of what he did with reference to the other witnesses, unaffected by the cloud which the evidence offered would have cast upon them. He was acting in the course of his employment, for he was employed to procure witnesses. The power of the corporation was intrusted to him with reference to that subject, to be used as he saw fit. His acts related solely to that subject, and were done by him, as its agent, wholly for its benefit. If this evidence would have been admissible against an individual defendant who had employed Kaufmann as he was employed, it is admissible against this corporate defendant. If an honest man by mistake employs a dishonest one to look up witnesses for him, and the latter, through excess of zeal, resorts to bribery, although it was never thought of by his employer, it is better, for cleanliness and purity in the administration of justice, that the facts should be shown, with the fullest opportunity for explanation, than to exclude all evidence of the evil acts upon the ground that they were not authorized, because authority may properly be inferred from the nature of the employment. In such a case all doubt

should be resolved, if possible, in the interest of clean evidence and the exposure of foul practices.

There are but few authorities which bear directly upon this branch of the subject. We have the general rule that a principal is liable to a third person in a civil action for the fraud or other malfeasance of his agent perpetrated by the latter in the course of his employment, although the act was *ultra vires*, and the principal did not authorize, justify, or know of it. *Palmeri v. Railway Co.*, 133 N. Y. 261, 30 N. E. 1001, 16 L. R. A. 136, 28 Am. St. Rep. 632; *Fifth Ave. Bank v. Forty-Second St. & G. St. F. R. Co.*, 137 N. Y. 231, 33 N. E. 378, 19 L. R. A. 331, 33 Am. St. Rep. 712; *Jarvis v. Beach Co.*, 148 N. Y. 652, 43 N. E. 68, 31 L. R. A. 776, 51 Am. St. Rep. 727; *Railroad Co. v. Schuyler*, 34 N. Y. 30; *Stewart v. Railroad Co.*, 90 N. Y. 588, 43 Am. Rep. 185. As was said in an important case in England: "If the agents employed conduct themselves fraudulently, so that if they had been acting for private employers the persons for whom they were acting would have been affected by their fraud, the same principles must prevail where the principal under whom the agent acts is a corporation." *Ranger v. Railway Co.*, 5 H. L. Cas. 86, 87. So this court has declared that "where authority is conferred to act for another, without special limitation, it carries with it by implication authority to do all things necessary to its execution; and when it involves the exercise of the discretion of the servant, or the use of force towards or against another, the use of such discretion or force is a part of the thing authorized, and when exercised becomes, as to third persons, the discretion and act of the master, and this although the servant departed from the private instructions of the master, provided he was engaged at the time in doing his master's business and was acting within the general scope of his employment. \* \* \* In most cases where the master has been held liable for the negligent or tortious act of the servant, the servant acted not only without express authority to do the wrong, but in violation of his duty to the master." *Rounds v. Railroad Co.*, 64 N. Y. 129, 133, 21 Am. Rep. 597. So far as this rule rests upon estoppel, it does not apply to the question before us, but so far as it rests upon public policy or convenience it has some bearing; for the interest of the public is promoted by the exposure of corrupt acts intended to turn the course of justice.

The authorities directly in point, so far as they have been called to our attention, with one exception, support the theory that the evidence in question should have been received. In the leading case evidence was admitted to show that a clerk in the employ of the defendant, a railroad corporation, offered money to a witness for the plaintiff to influence his testimony in favor of the company. It was the duty of the clerk to look up and arrange the evidence in cases where the company had been sued by persons injured, without special directions, and with general authority to use his own judgment. It expressly appeared that he had no authority "to deal with a witness in any way," and that if he



had used money to suborn a witness he would have been instantly discharged. The court, referring to the authority of the clerk, said: "He was empowered generally to perform that duty, without special directions. That part of the business of the company was placed in his charge, with general authority to use his judgment in its performance. His acts, therefore, were the acts of the company, within the scope of his employment. His legal authority, of course, but extended to lawful acts. So it is true of all agencies, as they are not appointed for the purpose of committing wrong or the performance of illegal acts, except in rare cases. Few actions would be maintainable if a recovery could be had only in cases where express authority is given, or the agent is required to commit the wrong. \* \* \* In this case the clerk was in the exercise of a corporate power, engaged in the performance of a duty delegated to him by the company, and in the performance of that duty he attempted the use of illegal means for the accomplishment of a legal end, and for the benefit of the company. He did not attempt to suborn the witness for the benefit of himself, but for the benefit of the company,—not with the consent of his superior, but in the course of the legitimate and authorized business of the company. He was unquestionably employed by the company, was acting for it, and did the act to promote its interest. He was engaged in the performance of a duty for the company. He did the act as a part of the duty, although unauthorized. We are therefore of the opinion that he performed the illegal and unauthorized act while acting in and as a part of his employment, and we must hold the company is responsible for the act. For that reason, we hold that the evidence was admissible." *Railway Co. v. McMahon*, 103 Ill. 485, 42 Am. Rep. 29. In *Snell v. Bray*, 56 Wis. 156, 14 N. W. 14, a man who expected to be sued requested a friend to write to an acquaintance, but did not authorize him to attempt to influence her testimony if she was called as a witness on the other side. The friend wrote to this person, warning her not to aid the other party or testify in the action; and it was held that the letter was properly received in evidence, as an admission by conduct, although it was written before the action was commenced. In *Railroad Co. v. Rambo*, 59 Fed. 75, 8 C. C. A. 6, it was said that "it was competent for the plaintiff to introduce evidence in rebuttal tending to show that the authorized agent of the Baltimore & Ohio Railroad Company had been engaged in suborning witnesses to testify falsely. Such evidence was relevant on the main issue, as tending to show an admission by its conduct that it had a bad case, needing false and perjured evidence to support it." In *Green v. Town of Woodbury*, 48 Vt. 5, it was held that evidence was not admissible to show that a constable employed to subpoena witnesses and assist in the defense of a town had offered inducements to one of the plaintiff's witnesses to keep away from the trial, when it did not appear that any other officer or agent of the town was cognizant of, authorized, or approved the act. The rule laid down by the supreme court of Illinois in the case cited is the better calculated to advance jus-

tice by keeping its channels pure. It tends to prevent perjury and fraud, and to strengthen the confidence of the people in the courts. Upon principle, as well as according to the weight of authority, proof of Kaufmann's attempt to bribe Klein to swear falsely for the defendant should have been received. The judgment should be reversed, and a new trial granted, with costs to abide the event.

LANDON, J. (dissenting). When the servant in the act of executing his master's business does wrong to the injury of another, the master is liable, although he had not authorized the wrong. But when such unauthorized wrong of the servant does no injury to any one the master should not be punished for his servant's sin. That is this case. There is much authority the other way. It rests in great part upon the praiseworthy desire to punish the attempt upon the purity of justice. But this will not justify imputing to the innocent the wrong of the guilty. Some evidence tending to support the inference of permission or acquiescence on the part of the master should be given. I advise affirmance.

PARKER, C. J., and BARTLETT and MARTIN, JJ., concur with VANN, J., for reversal. O'BRIEN and HAIGHT, JJ., concur with LANDON, J., for affirmance.

Judgment reversed, etc.

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## VI. Relation between Directors or Officers and Stockholders \*

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### SMITH v. HURD.

(Supreme Judicial Court of Massachusetts, 1847. 12 Metc. 371,  
46 Am. Dec. 690.)

This was a special action on the case, by a stockholder of the Phoenix Bank, against those who were directors of the said bank, for several years next before and at the time of the failure of said bank, in October, 1842. There were two counts; one founded in nonfeasance of official duty, the other in misfeasance.

The defendants demurred to the declaration, and the plaintiff joined in demurrer.

SHAW, C. J.<sup>o</sup> This is certainly a case of first impression. We are not aware that any similar action has been sustained in England, or in any of the courts of this country. It is founded on no statute. It is an action on the case, at common law, brought by an individual holder of shares in an incorporated bank, against the directors, not including the president, setting forth various acts of negligence and

\* For discussion of principles, see Clark on Corp. (3d Ed.) § 213.

<sup>o</sup> The statement of facts is abridged.

malfeasance through a series of years, in consequence of which, as the declaration alleges, the whole capital of the bank was wasted and lost, and the shares of the plaintiff became of no value. The circumstance that no such action has been maintained would certainly be no decisive objection, if it could be shown to be maintainable on principle. But the fact, that similar grievances have existed to a great extent, and in numberless instances, where such an action would have presented an obvious and effective remedy, affords strong proof, that in the view of all such suffering parties, and their legal advisers and guides, there was no principle on which such an action can be maintained.

If an action can be brought by one stockholder, it may be brought by the holder of a single share; so that for one and the same default of these directors, thirty-five hundred actions might be brought. If it may be sustained by proof of an act, or series of acts, of carelessness, neglect, and breach of duty in managing the affairs of the bank, by which the whole value of the stock is destroyed, it may, on the same principle, be maintained on any act or instance of such negligence, by which the shares are diminished in value, fifty, ten, five or one per cent. Still, notwithstanding these consequences, if the plaintiff has a good right of action, upon recognized and sound legal principles, his action ought to be sustained.

But the court are of opinion that the action cannot be maintained; and that on several grounds, a few of the more prominent of which may be alluded to.

1. There is no legal privity, relation, or immediate connection, between the holders of shares in a bank, in their individual capacity, on the one side, and the directors of the bank on the other. The directors are not the bailees, the factors, agents, or trustees of such individual stockholders. The bank is a corporation and body politic, having a separate existence as a distinct person in law, in whom the whole stock and property of the bank are vested, and to whom all agents, debtors, officers, and servants are responsible for all contracts, express or implied, made in reference to such capital, and for all torts and injuries diminishing or impairing it. The very purpose of incorporation is, to create such legal and ideal person in law, distinct from all the persons composing it, in order to avoid the extreme difficulty, and perhaps it is not too much to say the utter impracticability, of such a number of persons acting together in their individual capacities. The practical difficulty would be nearly as great whether it were held that all must join in an action to recover damage for an injury to the common property, or that each might sue separately.

The stockholders do, indeed, ordinarily elect the directors; but it is as parts and members of the corporation, in their corporate capacity, in modes pointed out by the charter and by-laws, so that the directors are the appointees of the corporation, not of the individuals. Indeed, I believe there is a provision in the bank charters—there certainly was formerly—which is equally to the present purpose; namely, that the



Commonwealth shall be at liberty to add a certain amount to the capital of various banks, and appoint a proportional number of directors. Such directors, so appointed, pursuant to the charter regulating the legal organization of the body, would stand in all respects on the footing of directors chosen by the stockholders. If these were liable to the action of individual stockholders, those would be in like manner.

2. The individual members of the corporation, whether they should all join, or each act severally, have no right or power to intermeddle with the property or concerns of the bank, or call any officer, agent, or servant to account, or discharge them from any liability. Should all the stockholders join in a power of attorney to any one, he could not take possession of any real or personal estate, any security or chose in action; could not collect a debt or discharge a claim, or release damage arising from any default; simply because they are not the legal owners of the property, and damage done to such property is not an injury to them. Their rights and their powers are limited and well defined. They are members of an organized body, and exercise such powers as the organization of the institution gives them. Stockholders in banks have a separate right to dividends, when declared, and to a distributive share of the capital stock, if any remains when the charter of the bank is at an end, and its debts paid.

3. But another important consideration is, that the injury done to the capital stock by wasting, impairing, and diminishing its value, is not, in the first instance, nor necessarily, a damage to the stockholders. All sums which could, in any form, be recovered on that ground, would be assets of the corporation, and when collected and received by directors, receivers, or any other persons entitled to receive the same, they would be held in trust, first to redeem the bills and pay the debts of the bank; and it would be only after these debts were paid, and in case any surplus should remain, that the stockholders would be entitled to receive anything. It is, therefore, an indirect, contingent, and subordinate interest, which each stockholder has, in damages so to be recovered against directors. If, upon such indirect, contingent, and remote interest, individual stockholders could recover for the defaults of directors, and especially, as is alleged in this case, where these defaults have been so great as to sink the capital, a fortiori would the creditors of the bank individually have a right to maintain similar actions; because their claim upon the funds, being prior to that of stockholders, would be somewhat more immediate and direct.

In the same connection, it is obvious to remark, that a judgment in favor of one stockholder would be no bar to an action by a creditor, nor a judgment by both, to an action by the corporation.

4. But it is said, that although the real and personal estate, the securities and capital stock, are, in legal contemplation, vested in the corporation, yet the individual has a separate and distinct property and interest in his particular shares, by any injury to which he may have a separate damage. To some extent, it is true that he has a several in-

terest in his share; but it is to be taken with some qualifications. Strictly speaking, shares in a bank do not constitute a legal estate and property; it is rather a limited and qualified right which the stockholder has to participate, in a certain proportion, in the benefits of a common fund, vested in a corporation for the common use; it is a qualified and equitable interest, a valuable interest manifested usually by a certificate, which is transferable. To the extent of this separate and peculiar interest, a stockholder, no doubt, might maintain his separate and special action, according to the nature of the wrong done to him in respect to it; as trover or trespass, for the conversion or tortious taking of his certificate; trespass on the case for refusing to make a transfer on a proper occasion; assumpsit for a dividend declared, and the like. But an injury done to the stock and capital, by negligence or misfeasance, is not an injury to such separate interest, but to the whole body of stockholders in common. It is like the case of a common nuisance, where one who suffers a special damage, peculiar to himself, and distinguishable in kind from that which he shares in the common injury, may maintain a special action. Otherwise, he cannot. Co. Lit. 56a; 3 Steph. N. P. 2372; *Lansing v. Smith*, 8 Cow. (N. Y.) 146.

But we are pressed with the argument, that for every damage which one sustains, which is caused by the wrongful act of another, he ought to have a remedy. This is far from being universally true. Another maxim in regard to claims for damage is, *causa proxima, non remota, spectatur*. Thousands of instances occur, in which one sustains consequential and incidental damage from the misconduct of another, without a remedy at law. By the misconduct of the officers or agents of a parish, town, county, or even of the State or the Union, defalcations may take place, treasure be squandered and wasted, and all the members of the respective aggregate bodies suffer damage, for which the law, from the nature of the case, can afford no direct remedy. But the true answer to the objection is, that stockholders have a remedy, a theoretic one indeed, and perhaps often inadequate, in the power of the corporation, in its corporate capacity, to obtain redress for injuries done to the common property, by the recovery of damages; and each individual stockholder has his remedy through the powers thus vested in the corporation, for the common benefit.

On the whole, the court are of opinion that the demurrer is well taken, and that the action cannot be maintained.

## RIGHTS AND REMEDIES OF CREDITORS

I. Assets of a Corporation as a "Trust Fund" for Creditors<sup>1</sup>

## COLE v. MILLERTON IRON COMPANY.

(Court of Appeals of New York, 1892. 133 N. Y. 164, 30 N. E. 847,  
28 Am. St. Rep. 615.)

Action by plaintiff, a judgment creditor of the National Mining Company to have set aside a conveyance made by it of all its property to the Millerton Iron Company, and to secure the release of the property from a mortgage executed by said company.

FINCH, J.<sup>2</sup> The plaintiff is a creditor of the National Mining Company, a corporation formed and existing under the laws of this state. He commenced an action to recover damages done to his property by the wrongful act of the corporation, serving the summons in October, 1887, and recovering judgment in July of the next year. During the pendency of the action all the property and assets of the debtor corporation were transferred to the Millerton Iron Company, also a domestic corporation, upon a nominal consideration, except an assumption by the vendee of the debts of the vendor, and thereupon the former executed a mortgage to the Mercantile Trust Company covering all its property, including that acquired from the National Mining Company. When the plaintiff obtained his judgment nothing remained upon which it was a lien and his execution was returned unsatisfied. He then began this action, in which he assailed the transfers made with a view of subjecting the property of the debtor corporation to the satisfaction of his debt. Upon the trial his complaint was dismissed, but the general term reversed the judgment and ordered a new trial. From that order the trust company alone appeals and has given the usual stipulation for judgment absolute.

The trial court has refused to find that the National Company was insolvent at the date of its transfer, but did find that such transfer suspended and terminated the regular business of the grantor, and was made and accepted with that purpose and intention. The practical effect was to dissolve the grantor corporation and subject its charter to forfeiture at the hands of the state, for it voluntarily stripped itself of all its property and assets and became incapable, and intended to be and remain incapable, of performing its corporate duties. Such a transfer, which involves the destruction of the corporation and an abandonment of the purposes of its organization, is illegal as against

<sup>1</sup> For discussion of principles, see Clark on Corp. (3d Ed.) § 216.

<sup>2</sup> The statement of facts is abridged.



creditors, whose rights are thereby sacrificed and their remedies destroyed. The transfer was illegal, also, because made in contemplation of insolvency. Those who accomplished it knew that its necessary and inevitable effect would be to make the corporation unable to pay its debts, and must be held to have intended that consequence of their acts. I do not agree to that reading of the statute which limits its prohibition to cases in which payment of some note or obligation has been previously refused. An interpretation so narrow would seriously main and distort the obvious purpose of the statute and make a transfer, in contemplation of insolvency, good the day before a note matured and bad the day after. As against the creditor the transfer to the Millerton Company was illegal and in fraud of its rights. The assets of a corporation are a trust fund for the payment of its debts upon which the creditors have an equitable lien, both as against the stockholders and all transferees, except those purchasing in good faith and for value. *Bartlett v. Drew*, 57 N. Y. 587; *Brum v. Ins. Co. (C. C.)* 16 Fed. 140, 4 Woods, 156; *Morawetz on Corporations*, 791. The Millerton Company was not such a purchaser. It parted with nothing. It knew and participated in the illegal purpose to destroy the National Company, to make it utterly insolvent, and to deprive its creditors of the trust fund upon which they had a right to rely, and so they were at liberty to set aside the transfer so far as it barred their remedy and to enforce their equitable lien upon the property in the hands of the transferee.

It is not a sufficient answer to say that the transfer was rather formal than real, because, before its occurrence, the Millerton Company, having the same stockholders and officers, managed and conducted the business of the National Company before the transfer as well as after, and that what occurred was a practical consolidation. Companies may consolidate, but under the permission and safeguards of the statute, all of which were disregarded, and what is called the formal transaction cuts off and destroys the right of the creditor, and is being used for that exact purpose.

Neither is it an answer to say that the creditor is not harmed by a change of the party liable to pay, unless there be some disproportion in the assets. He cannot be forced to change his debtor against his will, and it appears in the proof that the transfer to the Millerton Company was followed by a mortgage sweeping in it to its lien and peril the very property transferred.

We are satisfied, therefore, that the plaintiff was entitled to judgment of sequestration and for a receiver, and so the order of the general term was right. The judgment obtained by Chapman is not a bar to the remedy. It is not relied upon for that purpose, and the appointment of a receiver was without notice to the attorney-general, as the law required. (*Laws of 1883, ch. 378.*) In the present case the plaintiff must give such notice when he applies for the appointment.

The rights of the mortgagee, who is the present appellant, need not now be accurately determined. Whether that mortgage was valid at all for wants of proper consents, or whether any of the bondholders have acquired equities superior to those of the plaintiff, may or may not become questions in the future. Enough appears to show that some of them do not stand in the attitude of bona fide creditors, and that the remedies of all may be confined to the property of the Miller-ton Company not derived from the National, until at least the former is exhausted. Those questions, however, may be left to the developments consequent upon further proceedings.

The order of the general term should be affirmed and judgment absolute for the plaintiff should be rendered upon the stipulation, with costs. All concur.

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### DOWNER v. UNION LAND CO. OF ST. PAUL.

(Supreme Court of Minnesota, 1911. 113 Minn. 410, 129 N. W. 777.)

Action by T. B. Downer against the Union Land Company of St. Paul and others. From an order overruling a demurrer to the defense, plaintiff appeals. Reversed.

START, C. J. This is an appeal by the plaintiff from an order of the district court of the county of Ramsey overruling his demurrer to the second alleged defense in the answer of the defendant Willius.

The action was commenced in December, 1909. The here material allegations of the complaint, briefly stated, are to the effect following: The defendant Union Land Company, hereafter referred to as the company, is and has been since 1887 a corporation for pecuniary profit duly organized under the laws of this state. On April 5, 1887, it issued 17,000 shares of its capital stock, of the par value of \$100 each, as full paid to its organizers of which 50 shares were delivered to the defendant Willius, hereafter referred to as the defendant. The company, after such issue of stock, became indebted in the sum of \$98,000, and thereafter, for the purpose of securing the money to pay such indebtedness, it issued its bonds, amounting in the aggregate to \$126,000, with 10 per cent. annual interest, payable to trustees or bearer February 1, 1894. The plaintiff purchased 6 of such bonds, each for \$500, and paid therefor \$3,000, relying upon the representation that the 17,000 shares of stock so issued had been paid for in full. None of his bonds, or any part thereof, were paid, except interest to August 1, 1895. He recovered a judgment against the company in the district court of the county of Ramsey, on February 5, 1902, for the amount due on the bonds, \$4,979.83. Execution was issued on the judgment and returned satisfied only to the extent of \$1,023.87. The balance of the judgment has never been paid and the company is insolvent. The organizers and stockholders of the company, including the defendant, with the intent of acquiring the 17,000 shares of stock

as full paid, when in fact they were not, purchased 1,476 acres of land, for which they paid only \$679,289, which was more than it was worth. They caused this land, with cash sufficient to make the price actually paid for the stock not more than \$850,000, to be transferred and turned over to the company in payment of the 17,000 shares of stock, an overvaluation of the land of more than \$790,000. Such valuation was not the result of mistake, but was a gross overvaluation, intentionally made by all the parties to the transaction, with the knowledge of all the past and present stockholders of the company, and with the intent to enable such stockholders to acquire, and they did thereby acquire, each his respective portion of the 17,000 shares of the capital stock, by paying to the company therefor not to exceed \$50 per share. The 17,000 shares so issued are the only portion of the authorized capital stock of the company which was ever issued. The plaintiff did not discover the fraudulent character of the issue of the 17,000 shares, and was unable with due diligence to discover the same, until the summer of 1906, and such discovery was then for the first time made after several years of diligent inquiry. The complaint then alleges in detail the steps taken by the plaintiff to ascertain the facts as to the issue of such stock. The complaint prays, in effect, judgment against the company for the amount due on the original judgment, and that each of the defendant stockholders be required to pay so much of the difference between the par value of his stock and the amount actually paid by him therefor as may be necessary to pay the judgment against the company, and for general relief.

The answer of the defendant avers four alleged defenses, viz.: (1) The stock was in fact fully paid. (2) The plaintiff's bonds contained an express agreement that the stockholders should in no wise be liable for their payment. (3) The action is barred by the statute of limitations. (4) Laches.

The plaintiff replied to all the alleged defenses, except the second, to which he demurred. The trial court overruled the demurrer. The second alleged defense was to the effect: That the bonds of the company drew interest from their date at the rate of 10 per cent. per annum, and their payment was secured by a trust deed of all of the corporate property. That each purchaser of the bonds, including the plaintiff, entered into an agreement with the company, in consideration of the high rate of interest and the provision for the payment of the bonds, which was included in the body of each bond in these words: "It is a condition of the issue of this bond and the execution of said trust deed that this bond is an obligation of said company only" (meaning said defendant land company) "and that the stockholders of said company shall not, nor shall any of them, be in any wise liable for the payment thereof, nor shall any holder of this bond be entitled to any remedy to enforce payment thereof against any stockholder. The holder of this bond accepts this condition and agrees to the terms



thereof." And further, that no representations were ever made to the plaintiff that the shares of stock issued by the company were fully paid, or to any extent, except such representations as may be deemed to have arisen from the mere fact that 17,000 shares had been issued as fully paid, of which 12,132 shares were outstanding when the plaintiff purchased his bonds.

1. The first contention of the defendant in support of the order, overruling the demurrer, to be considered, is that the complaint does not allege facts sufficient to constitute a cause of action, for the reason that on its face it appears that the alleged cause of action is barred by the statute of limitations. A demurrer, as a general rule, searches the record, and judgment will be given against the party whose pleading was first defective in substance. It is not clear that this rule is here applicable, for the reason that the question whether the alleged cause of action is barred by the statute of limitations has become, by the answer pleading the statute and the reply thereto, an issue of fact between the parties. 1 Chitty, Pl. 669; 6 Enc. of Pr. P. 332; Hanson v. Byrnes, 96 Minn. 50, 104 N. W. 762. This point, however, is not raised by the plaintiff, and we assume, for the purpose of this appeal only, that the demurrer in this case fastens upon the first defective pleading. The question of the sufficiency of the complaint is, then, to be determined as if the demurrer was to the complaint. It is the settled rule of this court that, in an action for relief on the ground of fraud consummated more than six years before the commencement of the action, the complaint must allege facts showing that the fraud was not discovered until within six years next before the action was commenced; that, if it fails so to do, demurrer will lie, but in such a case, if the bar of the statute is not raised either by demurrer or by answer, it is waived. Humphrey v. Carpenter, 39 Minn. 115, 39 N. W. 67; Burk v. Land Ass'n, 40 Minn. 506, 42 N. W. 479; Morrill v. Little Falls Co., 53 Minn. 371, 55 N. W. 547, 21 L. R. A. 174; Duxbury v. Boice, 70 Minn. 113, 72 N. W. 838; First National Bank v. Strait, 71 Minn. 69, 73 N. W. 645; Schmitt v. Hager, 88 Minn. 413, 93 N. W. 110.

A consideration of the allegations of the complaint, as to when the plaintiff discovered the fraud and his diligence in the premises, in connection with the rule stated, has led us to the conclusion that it does not appear upon the face of the complaint as a matter of law that the alleged cause of action is barred by the statute of limitations. The question whether the plaintiff discovered the fraud, or ought to have discovered it by the exercise of reasonable diligence, more than six years before the commencement of the action, is peculiarly one of fact, and was properly made an issue of fact by the pleadings.

2. The pivotal question presented by the record is whether the contract as to stockholders' liability contained in the bonds is a defense on the merits to this action. The demurrer admits the execution of

the contract, the consideration therefor, and, therefore, its validity. Counsel for defendant contend that such contract is an absolute bar to this action, and cite in support of the claim, with others, the case of *Brown v. Eastern Slate Co. et al.*, 134 Mass. 590, which was an action to enforce the statutory liability of the defendant stockholders for the payment of certain promissory notes of the company. The statute (Pub. St. Mass. 1882, c. 106, § 61) provided that stockholders who had not paid in full the par value of their shares should be jointly and severally liable for the debts of the company. The notes were delivered upon a contemporaneous agreement that there should be no personal liability on the notes. It was held that, as no one was personally liable, except by statute, the contract necessarily referred to the statutory liability, and that it was a defense. Another case relied on is *U. S. v. Stanford*, 161 U. S. 412, 16 Sup. Ct. 576, 40 L. Ed. 751. In this case it was sought to enforce against the estate of Leland Stanford a claim of some \$15,000,000 based upon the Constitution and laws of California, making each stockholder of a railroad corporation liable for its debts in proportion to the stock held by him. It was held that the liability of stockholders of corporations for bonds issued under the Pacific Railroad acts depended, not upon the laws of California, but upon the acts of Congress under which such bonds were issued, which provided that the stockholders should not be personally liable for the debts of the corporation. The case of *Basshor v. Forbes*, 36 Md. 154, also cited, was an action to recover from a stockholder of a corporation the amount of its promissory note by virtue of a statute providing that stockholders should be liable for the debts of the corporation to an amount equal to that of their stock "until the whole amount of the capital stock fixed and limited by the corporation shall have been paid in full." Code Md. 1860, art. 26, § 52. It was held that an agreement, made at the time the note was delivered, that the payee should look only to the corporation and the security for its payment, was a defense.

These cases sustain the proposition that, if a person contracting with a corporation expressly agrees to look only to the corporation and its property for the payment of his debt against it, such agreement will be a waiver of the constitutional or statutory liability of stockholders for the payment of the debt. It is clear that the agreement contained in the bonds, which we have quoted, released the stockholders from any and all liability for the payment of the bonds imposed by the Constitution or statute, and from all liability whatever, in the absence of any element of fraud; that is, if they had then paid the full par value of their stock as represented by the issuance of it as full paid. This is not an action to enforce any constitutional or statutory liability of the defendant for the payment of the bonds; but it is, in effect, one to compel the defendants to make good, so far as may be necessary to satisfy the plaintiff's judgment against the corporation,

their alleged representation, alleged to have been relied upon by him, that the assets of the corporation had been increased to the full par value of their stock, when in fact only one-half thereof had been paid. The question, then, in its last analysis, is whether such a liability was within the contemplation of the parties when the bond agreement was made, and did the plaintiff thereby waive such liability in case he might thereafter discover for the first time the facts upon which liability must rest? The right of a creditor to maintain such an action is settled by the repeated decisions of this court. *First National Bank v. Gustin*, 42 Minn. 329, 44 N. W. 198, 6 L. R. A. 676, 18 Am. St. Rep. 510; *Hospes v. Northwestern Co.*, 48 Minn. 174, 50 N. W. 1117, 15 L. R. A. 470, 31 Am. St. Rep. 637; *Hastings Malt-ing Co. v. Iron Range Co.*, 65 Minn. 28, 67 N. W. 652; *Wallace v. Carpenter Co.*, 70 Minn. 321, 73 N. W. 189, 68 Am. St. Rep. 530.

The basis of the action is not contract, but fraud, for the reason that: People deal with the corporation and give it credit on the faith of its stock, and they have the right to assume that it has a paid-in capital to the amount which it represents itself as having. If the representation is false, it is a fraud on creditors; and, in case the corporation becomes insolvent, equity will compel the holders of bonus stock, or stock not in fact paid in full, to make the representation good, by paying the balance due on their stock to the extent necessary to pay creditors whose debts were contracted subsequent to the issuing of the stock as fully paid, and who are presumed to have relied on the representation. It is the misrepresentation of fact in stating the amount of capital to be greater than it is in fact which is the basis of the liability of the stockholders in such cases. A certificate for paid-up shares in a corporation is simply a written statement in the name of the corporation that the holder thereof is a stockholder, and that the full par value of his shares has been paid to the corporation. If the shares in fact have not been so paid for, the certificate that they have been is a false representation that the assets of the corporation have been increased to the amount of the par value of the stock so issued.

The very basis of this action clearly indicates that the alleged liability sought to be enforced in this action was not within the contemplation of the parties at the time the bond agreement was made, and that it was not waived thereby. How can the plaintiff be said to have waived a liability, when he had no knowledge of the facts out of which the alleged fraud and consequent liability sprung? Is it reasonable to assume that the company or its stockholders intended by the agreement to guard against liability for fraud which from their viewpoint never existed and was not then claimed by any one? We hold that the agreement here in question does not constitute a waiver by the plaintiff of the alleged liability sought to be enforced by this action, nor a defense thereto.



It was alleged in the second defense, and admitted by the demurrer, that no representations were ever made to the plaintiff that the shares of stock were fully paid, except the fact that they were issued as fully paid; that he made no inquiries either as to the amount thereof, or the amount paid thereon; and that he had no information in regard thereto. It is urged, in effect, on behalf of the defendant, that in view of this admission the plaintiff did not rely on any representation that the stock was fully paid. We cannot concur in this view of the effect of the allegations referred to. The complaint expressly alleged that the plaintiff, relying upon the representation that the shares had been paid in full, purchased and paid for his bonds. This allegation is put in issue by the general denial contained in the first defense. The allegation in the second defense relied on is simply a statement of evidentiary facts relevant to the issue whether the plaintiff did in fact rely upon the representation as alleged in the complaint. It does not appear upon the face of the second defense that the plaintiff did not rely upon the representation. With reference to a trial of this issue we deem it proper to say that the presumption of reliance by creditors upon the representation that stock issued as fully paid is so in fact is only *prima facie*. The rule in such cases is that: "It is only those creditors who have relied, or who can fairly be presumed to have relied upon the professed amount of capital, in whose favor the law will recognize and enforce an equity against the holders of 'bonus stock.'" *Hospes v. Northwestern Co.*, 48 Minn. 174, 50 N. W. 1117, 15 L. R. A. 470, 31 Am. St. Rep. 637.

It follows that the demurrer to the defense should have been sustained.

Order reversed.

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## II. Interference in Management of Corporation <sup>3</sup>

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### POND v. FRAMINGHAM & LOWELL R. R. CO.

(Supreme Judicial Court of Massachusetts, 1881. 130 Mass. 194.)

MORTON, J. This is a bill in equity, the substantial allegations of which are, that the plaintiffs are creditors of the defendant corporation; that the corporation is insolvent; that all its property is mortgaged to trustees for the benefit of one class of creditors; that it owes large amounts to other creditors, one of whom has attached all its property; that it is about to execute a lease to said attaching creditor for the term of nine hundred and ninety-nine years, at a rental which will

<sup>3</sup> For discussion of principles, see Clark on Corp. (3d Ed.) § 217.

not pay the interest upon its intledtedness, and that the execution of said lease would be injurious to the interest of its creditors and stockholders. The prayer is for an injunction to restrain the defendant from further prosecuting its business, and for the appointment of receivers.

There is no statute giving this court equity jurisdiction in such a case as this, and the bill does not state a case within the general equity powers of a court of chancery. As is stated in *Treadwell v. Salisbury Manuf. Co.*, 7 Gray, 393, 66 Am. Dec. 490: "It is too well settled to admit of question, that a court of chancery has no peculiar jurisdiction over corporations, to restrain them in the exercise of their powers, or control their action, or prevent them from violating their charter, in cases where there is no fraud or breach of trust alleged as the foundation of the claim for equitable relief."

The plaintiffs cannot maintain this bill, unless upon the ground that any creditor can maintain a bill in equity against an individual debtor upon like allegations. But there is no allegation of fraud or breach of trust, or any other ground of jurisdiction, which brings the case within the general equity powers of a court of chancery. The bill is an attempt by a creditor to restrain his debtor from making what is alleged to be an improvident contract. The rights of the parties are governed by the rules of the common law. The plaintiffs as creditors might, by an attachment, have obtained security which would take precedence of the contemplated lease; but if they could not, the court has no power to restrain the debtor from making a disposition of his property which is permitted by the common law, unless fraud or breach of trust is alleged and shown.

The allegation that the defendant corporation is insolvent does not aid the plaintiffs. In the absence of any statute giving the power, this court has no authority to act as a court of insolvency for the liquidation of the affairs of an insolvent railroad corporation.

Decree dismissing the bill affirmed.

### III. Fraudulent Conveyances and Transfers <sup>4</sup>

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#### BOOTH v. BUNCE.

(Court of Appeals of New York, 1865. 33 N. Y. 139, 88 Am. Dec. 372.)

Appeal from the General Term of the Supreme Court, the second district, where a judgment entered on a verdict in favor of the plaintiff had been affirmed.

This was an action by Alfred Booth against Jeremiah S. Bunce and others, for the seizure and conversion of a steam-engine belonging to the plaintiff.

POTTER, J.<sup>5</sup> This case may be regarded as a contest between bona fide creditors, to secure their respective claims, in part or in whole, from certain personal property, to wit, a steam engine, and the question first to be determined is, in whom was the title to the property at the time it was levied upon and taken by the defendants. It is conceded, that the title to the engine in question, at the time of the plaintiff's levy upon it by his execution, was either in Montgomery and Lund, then lately composing the firm of Montgomery & Co., or in the corporation called "The New York Steam Saw-Mill and Machine Company." The plaintiff claims the title to have been in the former, the defendants claim it to have been in the latter. This, it will be seen, became the material issue to be tried at the circuit.

The organization of this company, in due form of law, was duly proved, and there was no evidence of its legal dissolution. The bed-plate and cylinder of this engine was transferred by Montgomery and Lund to this corporation, and its completion as an engine was subsequent to that time. The debt upon which the defendants' judgment was obtained was contracted by this corporation in the ordinary course of their business, and their judgment was against the corporation, and their execution was against the property of the corporation. The property, when so levied upon by the defendants, was in the possession of the plaintiff, who claimed to have made title to it under a judgment and execution, levy and sale thereunder, against William Montgomery and William Garrabrant.

William Montgomery & Co., before January, 1855, was composed of said Montgomery and Garrabrant, and one Isaac Reeve. Montgomery and Garrabrant purchased out Reeve's interest, and gave him notes upon which plaintiff's judgment was obtained in payment for Reeve's interest in the firm, Montgomery and Garrabrant continuing the firm of Montgomery & Co. Subsequently, Garrabrant sold out to

<sup>4</sup> For discussion of principles, see Clark on Corp. (3d Ed.) § 218.

<sup>5</sup> Statement of facts is abridged and a portion of the opinion is omitted.



Montgomery and George D. Lund purchased an interest in Montgomery's business and it was still continued to be carried on in the name of Montgomery & Co. Subsequently still, the Steam Saw-Mill and Machine Company was organized, and Montgomery & Co. transferred their business and assets to this corporation, and Montgomery was its president and principal executive, financial and managing agent. The plaintiff claims that the organization and conducting of this corporation was a fraudulent device of Montgomery & Co. to hinder, delay and defraud their creditors, and that, as to the plaintiff, the said organization, and acts of user under it, were nullities, being fraudulent and void. On the trial, the plaintiff offered evidence tending to prove this fraudulent device. The evidence was sufficient in strength to make it proper to have it submitted to the jury; and the learned judge charged the jury that they had to determine but one question, and that was, that if this corporation was fairly organized, and the sale of the property to them by Montgomery and Lund was also fair and done without fraudulent intent, the defendants were entitled to recover; if, on the contrary, the company was organized to defraud the creditors of Montgomery and Lund, and the property was transferred to them by Montgomery and Lund, in furtherance of that fraudulent purpose, the plaintiff was entitled to recover. This charge, I think, was entirely sound; no exception was made to it by either party. The jury found their verdict for the plaintiff. This, it appears to me, is conclusive upon this feature of the case.

It is insisted, that this corporation, being regularly organized, and the defendants their bona fide creditors, their corporate existence cannot be called in question, collaterally, and thus destroy the defendants' claim against them; that only the people of the state have a right to raise the question of their corporate rights. This argument is not sound as applicable to a case of fraud. As we have had occasion to repeat in another case, "it is a principle as old as the law of morals, and which has been engrafted into the law of equity and justice, that good faith is the basis of all dealing, and that every description of contract, and every transfer or conveyance of property, by what means soever it be done, is vitiated by fraud. Whether the contract be oral or in writing; whether executed by the parties with all the solemnities of deeds by seal and acknowledgment; whether in form of the judgment of a court, stamped with judicial sanction, or carried out by the devise of a corporation organized with all the forms and requirements demanded by the statute in that regard, if it be contaminated with the vice of fraud, the law declares it to be a nullity. Deeds, obligations, contracts, judgments, and even corporate bodies may be the instrument through which parties may obtain the most unrighteous advantages. All such devices and instruments have been resorted to, to cover up fraud, but whenever the law is invoked, all such instruments are declared nullities they are a perfect dead letter; the law looks upon them,

as if they had never been executed. They can never be justified nor sanctified by any new shape or cover, by forms or recitals, by covenants or sanctions which the ingenuity, or skill, or genius of the rogue may devise." The effect of this finding of the jury is, that this corporation was a devise resorted to by Montgomery and Lund to hinder, delay and defraud their creditors. As between the plaintiff and Montgomery and Lund, the plaintiff had a right to disregard the corporation as a void thing, and resort to the property of Montgomery to satisfy his demand.

Had the defendants, as bona fide creditors of this corporation (which was a valid corporation as to them), obtained a lien, by a prior levy under their judgment, it would have presented a different question. Their equities were, doubtless, equal to the plaintiff's—it was so held, when last before it was in this court—but the plaintiff was prior in time with his lien: "*Qui prior in tempore, potior est in jure.*" \* \* \* Judgment affirmed.

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#### IV. Remedies of Creditors against Stockholders<sup>6</sup>

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##### THOMAS v. MATTHIESSEN.

(Supreme Court of United States, 1914. 232 U. S. 221, 34 Sup. Ct. 312, 58 L. Ed. 577.)

On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit to review a judgment which affirmed a judgment of the Circuit Court for the Southern District of New York, dismissing the complaint in a suit to enforce the statutory liability of a stockholder in a foreign corporation. Reversed.

Mr. JUSTICE HOLMES delivered the opinion of the court:

This is a suit by a citizen of California, the holder of two notes made in California by the Wentworth Hotel Company, to recover from a stockholder in that corporation, a citizen of New York, a proportionate share of the sums due upon the same. The facts as agreed and found are as follows: The corporation was formed under the laws of the territory of Arizona, among many other things, to buy and sell real estate, "to build, maintain, operate, and carry on, in all its branches, the business of hotel keeping," and to build or purchase gas or electric works in Arizona or California, "both for its use in the hotel business and for the purpose of selling and disposing of the same." The principal place of business in Arizona was Tucson, and that outside of it was Los Angeles, California, with power to change to Pasadena, in that state. Before the incorporation, the defendant, residing in

<sup>6</sup> For discussion of principles, see Clark on Corp. (3d Ed.) §§ 234-236½.

New York, signed a writing reciting the intent of the subscribers to form a corporation in Arizona for the purpose of acquiring a portion of the Oak Knoll, and building a first-class hotel thereon; and he thereby subscribed for a certain number of shares. Later he took and paid for one thousand shares. The Oak Knoll is near Pasadena, in California, and the defendant and his associates intended the corporation to have the power to build and manage a hotel in that neighborhood, and expected that it would so do, but intended their liability to be controlled by the laws of Arizona.

The corporation complied with the laws of California, bought the land, built the hotel, went into business, and finally was adjudged insolvent. The notes in question were given for loans to the company. At the time of subscribing the defendant agreed with the company that he should be exempt from personal liability, and that neither the corporation nor its officers should have power to subject him or the other stockholders to it. Such exemption was expressed also in the certificate of incorporation. But by the statutes of California each stockholder of a corporation is personally liable for such proportion of the debts contracted while he is such, as the amount of his stock bears to the whole subscribed, and the liability of each stockholder of a corporation formed under the laws of any other state or territory of the United States, but doing business in California, is the same. Civil Code, § 322. The courts below ruled that the defendant could not be held, the circuit court of appeals citing *Risdon Iron & Locomotive Works v. Furness*, [1906] 1 K. B. 49, 75 L. J. K. B. N. S. 83, 54 Week. Rep. 324, 93 L. T. N. S. 687, 22 Times L. R. 45, 11 Com. Cas. 35, in which it was held that the law of California could not impose liability upon an English shareholder in an English corporation, without his assent. 113 C. C. A. 101, 192 Fed. 495.

We agree that without authority from the stockholder a corporation cannot make him answerable in a way not contemplated by the charter. We will assume for purposes of decision, although we express no opinion upon the point, that a provision for doing business in other states without any express reference to the possible difference in their laws would not be enough to change the rule. But a provision exempting the stockholder alongside of one authorizing the doing of business elsewhere cannot be taken to limit the latter authority to those states that grant a like exemption, or be deemed an attempt to override the law of the place where the business is to be done. That law may fail to operate for want of power over the person sought to be affected; but the charter leaves it open to that person to come in under it by assent. If the law of California forbade a foreign corporation to do business there unless all the stockholders filed a written assent to its conditions, the Arizona charter would not make such an agreement void. If this be true, then a particular stockholder may give such assent outside of the instrument of incorporation, and be bound by it.



In this case the defendant expressed in writing his wish that the corporation should set up a hotel in California. It is true that he also desired and stipulated that he should be free from personal charge. But that is merely the not infrequent occurrence of a party bringing about the facts and attempting to prohibit their legal consequence to which we lately had occasion to advert in *National City Bank v. Hotchkiss*, 231 U. S. 50, 56, 58 L. Ed. 115, 34 Sup. Ct. 20. See also *Butler v. Farnsworth*, 4 Wash. C. C. 101, 103, 104, Fed. Cas. No. 2,240. This, of course, he cannot do. In such cases the only question is which of two inconsistent orders is the dominant command. Here the usual prevalence of the specific over the general is fortified by the consideration that the building and carrying on of the California hotel was the main object for which the parties came together. When the defendant authorized that, he could not avoid the consequences by saying that he did not foresee or intend, or that he forbade them. He knew that California had laws, and he took his risk of what they might be, when, as we must hold, he gave his assent to doing business there. We cannot interpret his words as giving merely a conditional assent. We follow the language of *Pinney v. Nelson*, 183 U. S. 144, 46 L. Ed. 125, 22 Sup. Ct. 52, so far as it sanctions the views that we have expressed. See also *Thomas v. Wentworth Hotel Co.*, 158 Cal. 275, 280, 139 Am. St. Rep. 120, 110 Pac. 942.

There remains only the question whether the liability is of a kind that will be enforced outside of the California courts. Analysis on this point often is blurred by the vague statement that the liability is "contractual." An obligation to pay money generally is enforced by an action of *assumpsit*, and to that extent is referred to a contract, even though it be one existing only by fiction of law. But such obligations when imposed upon the members of a corporation may vary very largely. The incorporation may create a chartered partnership the members of which are primary contractors, or it may go no farther than to impose a penalty; or again, it may create a secondary remedy for a debt treated as that of the corporation alone, like the right to attach the corporation's real estate; or the liability may be inseparable from the local procedure; or the law may be so ambiguous as to leave it doubtful whether the liability is matter of remedy, and local, or creates a contract on the part of the members that will go with them wherever they are found. *McClaine v. Rankin*, 197 U. S. 154, 161, 49 L. Ed. 702, 705, 25 Sup. Ct. 410, 3 Ann. Cas. 500; *Christopher v. Norvell*, 201 U. S. 216, 225, 226, 50 L. Ed. 732, 736, 26 Sup. Ct. 502, 5 Ann. Cas. 740. In the present case we think that there can be no doubt of the meaning of the California statute. It reads: "Each stockholder of a corporation is individually and personally liable for such proportion of its debts and liabilities," etc., as we have stated, and supposes the action against him to be brought "upon such debt." Civil Code, § 322. This means that by force of the statute, if the corporation incurs a debt within the jurisdiction, the stock-

holder is a party to it, and joins in the contract in the proportion of his shares. And while the statutes of California cannot force an agent upon a foreign principal, still, if he has created such an agency in advance, he has come within the jurisdiction by his agent, as in other cases of contract made within a state from outside, and will be bound. *Flash v. Conn*, 109 U. S. 371, 27 L. Ed. 966, 3 Sup. Ct. 263; *Whitman v. National Bank*, 176 U. S. 559, 44 L. Ed. 587, 20 Sup. Ct. 477.

The defendant was a principal debtor. *Hyman v. Coleman*, 82 Cal. 650, 16 Am. St. Rep. 178, 23 Pac. 62. The fact that the corporation had deposits in the banks that held the notes did not discharge the notes pro tanto. *Strong v. Foster*, 17 C. B. 201, 25 L. J. C. P. N. S. 106, 4 Week. Rep. 151; *National Mahaiwe Bank v. Peck*, 127 Mass. 298, 34 Am. Rep. 368. The judgment must be reversed, and judgment entered for the plaintiff on the agreed facts.

Judgment reversed.

The CHIEF JUSTICE dissents.

Mr. JUSTICE HUGHES took no part in the decision.

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### BARTLETT v. DREW.

(Commission of Appeals of New York, 1874. 57 N. Y. 587.)

This was an action in the nature of a creditor's bill brought by plaintiff as judgment creditor of the New Jersey Steam Navigation Company after the return of an execution, nulla bona, to reach certain assets of the said company alleged to be in the hands of defendant Drew.

In September, 1866, the plaintiff recovered in the Supreme Court a judgment against the New Jersey Steam Navigation Company, a corporation created by the laws of the State of New Jersey, for \$836.-32 upon a cause of action accruing in the month of July, 1863. An execution upon the judgment was duly issued to the sheriff of the city and county of New York and returned unsatisfied. The corporation was created in February, 1839, with a capital of \$500,000, and had an existence of thirty years' duration which terminated in the month of February, 1869. In 1868 this action was commenced against the corporation and Daniel Drew, who was a large stockholder therein as well as a director and president of the board and a resident of the city of New York. The business of the corporation was that of a common carrier, transporting passengers and freight for hire by steamboats between New York and various eastern ports. It appeared that in December, 1863, by order of the board of directors, three steamboats of the company were sold for \$750,000, and in December, 1865, the proceeds of the sales were divided among the stockholders of the company, and the defendant, Drew, received for his



share an amount much larger than the plaintiff's judgment against the company.

REYNOLDS, C. It is insisted by the defendant, Drew, that the plaintiff can maintain no action against him alone, but that she must prosecute not only all the stockholders, to the end that each shall contribute his proportion to the payment of her debt, but her suit must be brought on her own behalf and on behalf of all the other creditors of the corporation who may choose to come in. In other words, in order to collect her debt against the company, she must institute a suit to wind up and finally settle all its affairs. That she might do this is not to be doubted, but that she of necessity must do it presents a different question. Prior to the distribution of the assets of the corporation due notice of the plaintiff's claim was given, and redress demanded, and the distribution was made with knowledge of the plaintiff's claim, and the corporation has no assets or property which can be taken on execution.

We are of the opinion that the plaintiff's right of action rests upon a very plain principle of equity. This is not a proceeding to dissolve and wind up the affairs of a corporation, or to marshal its assets, but the ordinary proceeding to collect a debt from a debtor unwilling to pay. The circumstance that the debtor is a foreign corporation, or that the defendant, Drew, was its president, director or stockholder, is quite immaterial, if it be found that Drew has any of the assets or property of the corporation which ought to be applied in payment of its debts. It is equally immaterial whether he got it by fair agreement with his associates, or by any wrongful act. If the law dooms it to the payment of the debts of the corporation it may be taken in some form by the creditor. It is a very plain proposition that the stock and property of every corporation is to be regarded as a trust fund for the payment of its debts, and its creditors have a lien and the right to priority of payment over any stockholder. 2 Story, Eq. Jur. § 1252. Where stock and property has been divided between stockholders before all the debts of the corporation have been discharged, if any one stockholder is compelled to pay more than his fair share of any unpaid debt he may resort to his associates for equitable contribution; but with that proceeding the creditor has nothing to do, unless he chooses to intervene to settle equities that may exist between his debtors. In the present case the corporation was proceeded against as an ordinary debtor, either unwilling or unable to pay. It turned out that it had no property which could be taken on execution; but it was found that the defendant, Drew, had a large amount of the assets in his possession, which belonged to the corporation when the plaintiff's demand accrued, and some portion of which should have been applied in discharge of its obligation to the plaintiff.

As before suggested, it does not matter how it came to the possession of the defendant, Drew. It is enough that he had it, and it was so much of the assets of the corporation as ought to be devoted to



the payment of the debts of the company, and his claim as a stockholder could not prevail over the creditor's prior right. *Curran v. State of Arkansas*, 15 How. 305, 14 L. Ed. 705; *Tinkham v. Borst*, 31 Barb. 407, 412; 2 Kent, Com. 307; 2 Story Eq. Jur. § 1252. This view of the case renders the consideration of several questions argued by the learned counsel for the defendant, Drew, in respect to parties and the form of proceeding, quite unnecessary. We are referred however to two cases in Massachusetts, of which a word may be said. *Vose v. Grant*, 15 Mass. 505; *Spear v. Grant*, 16 Mass. 9. They were both actions on the case at common law, by the billholder and creditor of a bank, whose charter had expired and assets distributed, against a stockholder who had received a portion thereof. The action proceeded entirely upon the theory that the distribution was wrongful before all the debts of the corporation were paid; and that for this alleged wrong an action on the case at common law might be maintained by a creditor against each stockholder who had profited by the wrongful division. After a very elaborate consideration by the court the right of action was denied, and whether properly or improperly does not affect the present case. The Supreme Judicial Court of Massachusetts had at that time no equity jurisdiction, and this circumstance was lamented by Jackson, J., in delivering the opinion of the court in the case first cited. Whether the apparent hardship of that case, or possibly of many others, had any influence, it is certain that soon after the law-making power of the State conferred upon the court equity jurisdiction.

With the nice distinction between law and equity we are not troubled in this case, nor even as to the form of the action. The plaintiff is a creditor of the New Jersey Steam Navigation Company for the amount of a judgment duly obtained. The company has no property in this State that can be taken on execution. The defendant, Drew, is found to be in possession of assets of the dissolved or insolvent corporation more than sufficient to pay the plaintiff her demand, and the law requires that he should pay it.

The judgment below should be affirmed, with costs. All concur.

## FOREIGN CORPORATIONS

### I. Status of a Foreign Corporation <sup>1</sup>

#### MAHAR v. HARRINGTON PARK VILLA SITES.

(Court of Appeals of New York, 1912. 204 N. Y. 231, 97 N. E. 587,  
38 L. R. A. [N. S.] 210.)

WILLARD BARTLETT, J. The question certified to this court by the Appellate Division (146 App. Div. 955, 131 N. Y. Supp. 1127) is as follows: "Does the complaint state facts sufficient to constitute a cause of action against the defendant, Harrington Park Villa Sites?"

The complaint alleges that at the city of New York, about July 27, 1909, the plaintiff had negotiations with the defendants regarding the sale by the defendants and the purchase by the plaintiff of certain lots of land situated at Harrington Park, N. J.; that thereafter the defendants and plaintiff entered into a written agreement for the sale of said property to the plaintiff; that the contract required plaintiff to pay to the Harrington Park Villa Sites, as a part payment thereon, the sum of \$500, and plaintiff delivered to said defendant a check on the Carnegie Trust Company, drawn to its order, which check was afterwards duly indorsed by said defendant and paid; that the Harrington Park Villa Sites, at the time named, was a foreign corporation, other than a money corporation, organized and existing under the laws of New Jersey, and had an office for the transaction of its business in the city of New York, and the transaction relating to and the making of the agreement above named took place in the city and state of New York; that at the time of the making of said agreement the Harrington Park Villa Sites had not filed with the Secretary of State of New York the statement required by law, and had not paid the tax or obtained a certificate to enable it, as a foreign stock corporation, other than a money corporation, to do business in the state of New York, and at said times was doing business in violation of section 15 of the general corporation law; and that the plaintiff under said contract deposited with the defendants the said sum of \$500, and before the commencement of this action demanded from them the aforesaid sum, no part of which has been paid. Upon these facts the plaintiff demanded judgment against the defendants for the sum of \$500 and costs.

The Harrington Park Villa Sites demurred, on the ground that the complaint did not state facts sufficient to constitute a cause of action,

<sup>1</sup> For discussion of principles, see Clark on Corp. (3d Ed.) §§ 247-249.

and on the additional ground that the court had no jurisdiction of the subject-matter, inasmuch as the action was brought to avoid a contract under seal in respect to real estate in New Jersey. The Municipal Court held that the complaint was good; the Appellate Term held that it was bad; the Appellate Division in turn has held that it was good, and the question now comes here.

The theory upon which the complaint has been upheld by the Appellate Division is that the contract therein mentioned was void, because made by a foreign stock corporation, other than a moneyed corporation doing business in the state of New York in violation of the provision of section 15 of the general corporation law (Laws of 1909, c. 28 [Consol. Laws 1909, c. 23]); and hence that there was a failure of consideration for the payment of the \$500 by the plaintiff, and an action lies to recover back the money. It is assumed in the prevailing opinion that this court held, in the case of *Wood & Selick v. Ball*, 190 N. Y. 217, 225, 83 N. E. 21, 23, that noncompliance with the requirements of that section has the effect of rendering any contracts made by such a corporation in this state absolutely void. Such is not my understanding of the purport of that decision. The only proposition decided in that case was "that compliance with section 15 of the general corporation law should be alleged and proved by a foreign corporation such as the plaintiff in order to establish a cause of action in the courts of this state." It is true that Judge Vann, in the course of the opinion, said that no such corporation could lawfully make contracts in this state without obtaining the required certificate in advance, and that he also spoke of contracts made by a corporation which had not obtained the certificate as "unlawful," and said that, in the absence of the certificate, a foreign stock corporation could not carry on business here, "except in violation of law." None of these expressions, however, necessarily imports that a contract thus made is absolutely void. The only penalty which the general corporation law itself prescribes for a disregard of the provisions of this section is a disability to sue upon such a contract in the courts of New York. "No foreign stock corporation doing business in this state shall maintain any action in this state upon any contract made by it in this state, unless prior to the making of such contract it shall have procured such certificate." Cons. Laws, c. 23, § 15. This prohibition would be effective to prevent the appellant from suing the respondent upon the contract alleged in the complaint; but, in my opinion, it is not operative to wholly invalidate the contract. I think that the penalty imposed upon a foreign stock corporation for doing business in New York without the certificate of authority required by section 15 of the general corporation law is limited to that thus prescribed in the section itself. No doubt the Legislature could have gone further and declared all contracts to be void which were made by a foreign stock corporation doing business in this state with-



✓ out having obtained the certificate; but it has not done so. This was the view taken in *Alsing Co. v. New England Quartz & Spar Co.*, 66 App. Div. 473, 73 N. Y. Supp. 347, affirmed 174 N. Y. 536, 66 N. E. 1110, where it was held that section 15 did not prevent a foreign stock corporation doing business here without having procured the necessary certificate from recovering upon a counterclaim growing out of the transaction upon which the plaintiff sued. "The defendant, having been brought into court and thus made to defend," said Mr. Justice O'Brien in that case, "should be allowed, unless there is a distinct provision to the contrary, not only to defend, but also to litigate any question arising out of the transaction that has been made the basis of the plaintiff's complaint." There is no such prohibitive provision in this statute; and therefore the obtaining of the certificate would not be a prerequisite to a recovery upon the counterclaim in question." 66 App. Div. 476, 73 N. Y. Supp. 350.

The Supreme Court of the United States has distinctly held that a contract made by a foreign corporation with a citizen of another state is not necessarily void because the corporation had not complied with the laws of such other state imposing conditions upon it as a prerequisite to the lawful transaction of business therein. In *Fritts v. Palmer*, 132 U. S. 282, 10 Sup. Ct. 93, 33 L. Ed. 317, a tract of land in Colorado had been conveyed to a Missouri corporation in disregard of constitutional and statutory provisions which prohibited a foreign corporation from purchasing or holding land in that state until it should acquire the right to do business therein by fulfilling certain prescribed conditions. Here the Missouri corporation had unquestionably violated the laws of Colorado when it purchased the property without having previously designated its place of business and an agent, as required by the Colorado statute. The only penalty which that statute provided, however, for noncompliance with these provisions was that the officers, agents, and stockholders should be personally liable on any contracts of such foreign corporation as might be in default. The Supreme Court held the fair implication to be that, in the judgment of the Colorado Legislature, this penalty was ample to effect the object of the statute, prescribing the terms upon which foreign corporations might do business in that state; and hence the judiciary ought not to inflict the additional and harsh penalty of forfeiting the estate which had been conveyed to the Missouri corporation. In other words, the court refused to treat the conveyance as void, notwithstanding that it was made to a corporation which was forbidden to receive it.

If I am right in assuming that the only infirmity in the contract mentioned in the complaint is the disability of one of the parties to it, namely, the foreign corporation, to sue upon it in the courts of this state, it remains a valid and effective instrument in all other respects. There is not a word in the complaint to indicate any other

defect. Here, then, we have the case of a contract which is not void and upon which the plaintiff has made a payment, which he was expressly required to make by its very terms, and where there is no intimation that the defendant corporation has failed in any respect to comply with the conditions on its part. It is manifest that these facts afford no basis for any legal claim whatever.

The complaint fails to disclose a cause of action, and therefore the order of the Appellate Division should be reversed, and the order of the Appellate Term affirmed, with costs in both courts, and the question certified answered in the negative.

CULLEN, C. J. I concur in the opinion of WILLARD BARTLETT, J., that the statute imposes only on the foreign corporation, which has not complied with the provisions of the laws of this state requisite to entitle it to do business therein, the penalty of being unable to maintain any action upon a contract made by it, not upon the other party to the contract. In other words, it can be sued upon the contract, but cannot sue thereon. Any other view would lead to astonishing results. Citizens of the state dealing with foreign corporations cannot be expected to know or to ascertain whether those corporations have complied with the laws of the state or not. Hence the contract was enforceable at the option of the plaintiff, and there has been no failure of consideration. But assume that the contract was void, as is the condition, under the statute of frauds, of an oral contract for the sale of land. The vendee cannot enforce it; nevertheless he is not entitled to recover money paid under it, unless the defendant refuses to fulfill. This appears to be settled law, not only in this state, but throughout the whole country. Collier v. Coates, 17 Barb. 471; Dowdle v. Camp, 12 Johns. 451; Abbott v. Draper, 4 Denio, 51; Erben v. Lorillard, 19 N. Y. 299, 304; Harris v. Frink, 49 N. Y. 24, 29, 10 Am. Rep. 318; Richards v. Allen, 17 Me. 296; Bennett v. Phelps, 12 Minn. 327 (Gil. 216); Congdon v. Perry, 13 Gray (Mass.) 3. The complaint does not allege that the defendant refused to carry out the contract, and until such refusal plaintiff was not entitled to recover back the money paid under the contract, good or bad.

HAIGHT, WERNER, CHASE, and COLLIN, JJ., concur with WILLARD BARTLETT, J. CULLEN, C. J., and VANN, J., concur in result.

Order reversed, etc.

*Noted*

## DAVID LUPTON'S SONS CO. v. AUTOMOBILE CLUB OF AMERICA.

(Supreme Court of United States, 1912. 225 U. S. 489, 32 Sup. Ct. 711, 56 L. Ed. 1177, Ann. Cas. 1914A, 699.)

In error to the Circuit Court of the United States for the Southern District of New York to review a judgment dismissing the complaint in an action by a foreign corporation upon a contract made by it in that state without a certificate of authority. Reversed and remanded with instructions to enter judgment for plaintiff.

Mr. JUSTICE HUGHES delivered the opinion of the court:<sup>2</sup>

The plaintiff in error, David Lupton's Sons Company, a Pennsylvania corporation, was engaged in the business of manufacturing and installing metal window frames and sash. Its factory was in Pennsylvania. In 1905 it entered into a contract in New York with the defendant, the Automobile Club of America, by which it agreed to manufacture and to place in position frames and sash for the defendant's building, to be erected in the city of New York, for the sum of \$10,344. While the Lupton Company was putting in the frames a strike occurred, and all the other persons employed by the defendant in the construction of the building stopped work on account, as it is found, "of the character and condition of labor" employed by the Lupton Company, and the material it furnished, of which complaint had been made by a New York labor union. After various negotiations, the defendant—under an adjustment by the architect, and in order to get its building constructed—employed another concern to complete the work embraced in the contract with the Lupton Company. The latter received, for what it did, \$5,837.72; the defendant paid for the completion \$3,796.76; and if this were credited against the contract price there would remain a balance of \$709.52.

The Lupton Company, insisting that it was wrongfully prevented from performance, brought this suit in the circuit court of the United States to recover the sum of \$5,000 as the damages sustained by the alleged breach. The defendant pleaded several defenses, as well as a counterclaim for damages for breach by the plaintiff. Among the defenses was one that the Lupton Company could not maintain this action because it was a foreign corporation doing business in the state of New York without a certificate of authority, in violation of § 15 of the general corporation law of that state. Laws of 1890, chap. 563, § 15; Laws of 1892, chap. 687, § 15, as amended.

Upon written stipulation the action was referred to a referee to hear and determine the issues. The referee reported his findings of fact and conclusions of law, holding that the contract was void under the statute and that the complaint should be dismissed. Upon the plaintiff's application, the report was recommitted in order that further findings

<sup>2</sup> Portions of the opinion are omitted.



might be proposed. The referee then passed on numerous requests submitted by the plaintiff, and on the filing of his supplemental report, which left unchanged the original conclusions of law, judgment was entered for the defendant. The Lupton Company brings the case here on writ of error to the circuit court, upon the ground that the New York statute, as applied to the transaction in question, was in contravention of the Constitution of the United States, as an unwarrantable interference with interstate commerce.

As the trial was had before the referee, pursuant to the stipulation, the only question presented here is whether there is any error of law in the judgment rendered by the court upon the facts found by the referee. The findings of fact are conclusive in this court. We cannot review any of the exceptions to these findings or to the refusal of the referee to find facts as requested. *Roberts v. Benjamin*, 124 U. S. 64, 71, 74, 31 L. Ed. 334, 336, 337, 8 Sup. Ct. 393; *Shipman v. Straitsville Min. Co.*, 158 U. S. 356, 361, 39 L. Ed. 1015, 1016, 15 Sup. Ct. 886; *Chicago, M. & St. P. R. Co. v. Clark*, 178 U. S. 353, 364, 44 L. Ed. 1099, 1105, 20 Sup. Ct. 924; *Hecker v. Fowler*, 2 Wall. 123, 17 L. Ed. 759; *Bond v. Dustin*, 112 U. S. 604, 28 L. Ed. 835, 5 Sup. Ct. 296; *Paine v. Central Vermont R. Co.*, 118 U. S. 152, 158, 30 L. Ed. 193, 195, 6 Sup. Ct. 1019.

Under section 15 of the general corporation law of the state of New York a foreign stock corporation, other than a moneyed corporation, is prohibited from doing business in the state without having first procured from the secretary of state a certificate that it has complied with certain prescribed conditions. The corporation is required (section 16) to file with the secretary of state a sworn copy of its charter and a statement setting forth the business which it proposes to carry on in the state; to designate its principal place of business within the state, and to appoint a person upon whom legal process may be served. *Wood & Selick v. Ball*, 190 N. Y. 217, 224, 83 N. E. 21. Section 15 provides: "No foreign stock corporation doing business in this state shall maintain any action in this state upon any contract made by it in this state unless, prior to the making of such contract, it shall have procured such certificate." In his original report, the referee found that the Lupton Company was doing business in the state of New York, within the meaning of the statute, without a certificate of authority; and after the report was recommitted, he made additional findings with respect to the nature of its business, upon which the plaintiff in error bases its contention that the statute has been held to apply to transactions in interstate commerce which were not subject to the state's interdiction. It is not necessary, however, to review these findings, for the statute has received a construction by the highest court of the state of New York which precludes it, in any aspect of the case, from being regarded as a bar to the maintenance of this action.

The referee's ruling that the contract was void was based upon the

statement in the opinion in *Wood & Selick v. Ball*, *supra*, that "the procuring of a license must precede the transaction of business, or the contracts of the corporation are not lawful." But in *Mahar v. Harrington Park Villa Sites*, 204 N. Y. 231, 38 L. R. A. (N. S.) 210, 97 N. E. 587, the court of appeals of New York has declared that a contract made by a foreign corporation doing business within the state without certificate of authority is not absolutely void; that the only penalty prescribed by the general corporation law for a disregard of the provisions of § 15 is a disability to sue upon such a contract in the courts of New York; and that the contract remains valid and effective in all other respects. \* \* \*

In this view, despite its transaction of business without authority, the foreign corporation could sue upon its contracts in any court of competent jurisdiction other than a court of the state of New York. Accordingly, it was held by the court of errors and appeals of New Jersey that a suit might be brought by the corporation in that state upon a contract made in New York, where it was doing business without the prescribed certificate. *Alleghany Co. v. Allen*, 69 N. J. Law, 270, 55 Atl. 724. The court conceded the general rule both in New Jersey and New York to be that a contract void by the law of the state where made would not be enforced in the state of the forum. But it was held that the New York statute did not in terms declare the contract void; it provided that no such action should be maintained in that state.

In dismissing the writ of error to review that judgment (*Allen v. Alleghany Co.*, 196 U. S. 458, 465, 49 L. Ed. 551, 556, 25 Sup. Ct. 311), this court commented upon the decision of the New York court in the case of the *Neuchatel Asphalte Co. v. New York*, 155 N. Y. 373, 49 N. E. 1043, which rose under the statute in an earlier form, the section (15) of the general corporation law then providing that the foreign corporation should not maintain "any action in this state upon any contract made by it in this state until it shall have procured such certificate." This court said: "The court of appeals in that case held that the purpose of the act was not to avoid contracts, but to provide effective supervision and control of the business carried on by foreign corporations; that no penalty for noncompliance was provided, except the suspension of civil remedies in that state, and none others would be implied. This corresponds with our rulings upon similar questions. *Fritts v. Palmer*, 132 U. S. 282, 33 L. Ed. 317, 10 Sup. Ct. 93."

It must follow, upon the similar construction of § 15, as it read at the time of the transaction in question, that the Lupton Company, whether or not it was doing a local business in New York, had the right to bring this suit in the Federal court. The state could not prescribe the qualifications of suitors in the courts of the United States, and could not deprive of their privileges those who were entitled under the Constitution and laws of the United States to resort to the Federal courts for the enforcement of a valid contract. *Union Bank v. Vaiden*, 18 How. 503, 507, 15 L. Ed. 472, 474; *Hyde v. Stone*, 20 How. 170.

175, 15 L. Ed. 874, 875; *Cowles v. Mercer County*, 7 Wall. 118, 122, 19 L. Ed. 86, 87; *Home Ins. Co. v. Morse*, 20 Wall. 445, 22 L. Ed. 365; *Barron v. Burnside*, 121 U. S. 186, 30 L. Ed. 915, 1 Interest. Com. 295, 7 Sup. Ct. 931; *Lawrence v. Nelson*, 143 U. S. 215, 36 L. Ed. 130, 12 Sup. Ct. 440; *Re Tyler*, 149 U. S. 164, 189, 37 L. Ed. 689, 697, 13 Sup. Ct. 785; *Barrow S. S. Co. v. Kane*, 170 U. S. 100, 111, 42 L. Ed. 964, 968, 18 Sup. Ct. 526. The state in the statute before us made no such attempt. The only penalty it imposed, to quote again from the *Mahar Case*, was a disability to sue "in the courts of New York." Before this decision of the state court, the circuit court of appeals for the second circuit reached the same conclusion as to the meaning of the statute, and upheld the right of the foreign corporation to sue in the Federal court. *Johnson v. New York Breweries Co.*, 101 C. C. A. 639, 178 Fed. 513. The court below erred in dismissing the complaint. \* \* \*

Judgment reversed and the cause remanded to the District Court with instructions to enter judgment in favor of the plaintiff for \$709.52, with interest from the date of the commencement of the action.

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#### SAULT STE. MARIE v. INTERNATIONAL TRANSIT CO.

(Supreme Court of United States, 1914. 234 U. S. 333, 34 Sup. Ct. 826, 59 L. Ed. 1337, 52 L. R. A. [N. S.] 574.)

Appeal from the District Court of the United States for the Western District of Michigan to review a decree enjoining the enforcement of a municipal ordinance requiring a Canadian corporation operating a ferry between Canada and the United States to take out a license and pay a license fee as a condition to conducting its business at its wharf in such municipality. Affirmed.

Mr. JUSTICE HUGHES delivered the opinion of the court:

This suit was brought by the International Transit Company, a Canadian corporation, to restrain the enforcement of an ordinance adopted, in the year 1911, by the city of Sault Ste. Marie, Michigan. The ordinance related to the maintaining of ferries from that city across the St. Mary's river to the opposite shore, in the province of Ontario; and the complainant contended that, as applied to it, the ordinance was a violation of the commerce clause of the Federal Constitution and of article 1 of the treaty of January 11, 1909 (36 Stat. at L. 2449), between the United States and Great Britain. The district court granted the relief as prayed (194 Fed. 522); and this appeal is brought.

The transit company holds a license from the Dominion government to operate a ferry between Sault Ste. Marie, Ontario, and Sault Ste. Marie, Michigan. It owns, and uses in this business, two steam ferry-boats of British registry; it leases a private wharf in the city of Sault Ste. Marie, Michigan, and there maintains an office where fares are received. The Canadian license prescribes the frequency of the serv-



ice and fixes the maximum fares to be charged; it also provides that the licensee shall not "infringe any of the laws or by-laws or of the regulations" of the United States or of the state of Michigan or "of the town of Sault Ste. Marie, U. S. A.," in reference to ferriage, "which may be applicable to the said ferry or such portion thereof as may be within the jurisdiction of any of them."

The city of Sault Ste. Marie, Michigan, was authorized by its charter to "establish, license, and regulate ferries to and from the city," and to prescribe rates. The charter also provided: "The council may regulate and license ferries from the city or any place or landing therein to the opposite shore \* \* \* and may require the payment of such reasonable sum for such license as the council shall deem proper; and may impose such reasonable terms and restrictions in relation to the keeping and management of such ferries, and the time, manner, and rates of carriage and transportation of persons and property, as may be proper; and provide for the revocation of any such license, and for the punishment, by proper fines and penalties, for the violation of any ordinance prohibiting unlicensed ferries and regulating those established and licensed." Under this authority, the city adopted the ordinance in question. Section 1 is as follows:

"No person, persons, or company shall operate a ferryboat, or engage in the business of carrying or transporting persons or property thereon from the city of Sault Ste. Marie, Michigan, and across the St. Mary's river to the opposite shore, without first obtaining a license therefor from the mayor, and by otherwise complying with the provisions of this ordinance."

The mayor was empowered to grant a license upon the payment of \$50 annually for each ferryboat engaged in such transportation, and it was further provided that, before any license should be issued, the person or company desiring the same should make application setting forth a schedule of the rates proposed to be charged within the prescribed territory. Additional provisions fixed the period and frequency of service and the rates to be charged from the licensee's dock within the city to the opposite shore. The mayor was authorized to revoke the license if he was satisfied that any of the provisions of the ordinance were violated. After the passage of this ordinance, one Pocock, operating a ferryboat belonging to the transit company without a license having been obtained therefor, was arrested and fined. Alleging the purpose of the city to enforce the ordinance, and its invalidity, the transit company then brought this suit.

It will be observed that the question is not simply as to the power of the state to prevent extortion and to fix reasonable ferry rates from the Michigan shore; it is not as to the validity of a mere police regulation governing the manner of conducting the business in order to secure safety and the public convenience. See *Port Richmond & B. Point Ferry Co. v. Hudson County*, decided this day, 234 U. S. 317, 58 L. Ed. 1330, 34 Sup. Ct. 821. The ordinance goes beyond this.

The ordinance requires a municipal license; and the fundamental question is whether, in the circumstances shown, the state, or the city, acting under its authority, may make its consent a condition precedent to the prosecution of the business. If the state, or the city, may make its consent necessary, it may withhold it. The appellee, having its domicile in Canada, is engaged in commerce between Canada and the United States. At the wharf which it leases for the purpose on the American shore, it receives and lands persons and property. Has the state of Michigan the right to make this commercial intercourse a matter of local privilege, to demand that it shall not be carried on without its permission, and to exact as the price of its consent—if it chooses to give it—the payment of a license fee?

This question must be answered in the negative. It is urged, on behalf of the city, that the state, either directly or through its municipalities, may establish and license ferries,—may grant ferry franchises. *Fanning v. Gregoire*, 16 How. 524, 14 L. Ed. 1043; *Conway v. Taylor*, 1 Black, 603, 17 L. Ed. 191; *Wiggins Ferry Co. v. East St. Louis*, 107 U. S. 365, 27 L. Ed. 419, 2 Sup. Ct. 257. But, since the decision in *Gloucester Ferry Co. v. Pennsylvania*, 114 U. S. 196, 29 L. Ed. 158, 1 Interst. Com. R. 382, 5 Sup. Ct. 826, it has been clear that, whatever authority the state may have for this purpose, it does not go so far as to enable the state to interdict one in the position of the appellee from conducting the commerce in which it is engaged, or justify the state in imposing exactions upon that commerce in the view that business of this character may be carried on only by virtue of its consent, express or implied. In that case the ferry company was a New Jersey corporation, receiving and landing its passengers and property at its wharf in Philadelphia in substantially the same manner as the appellee transacts its business at its wharf in Sault Ste. Marie, Michigan. The court held that it was not within the power of the state to prevent the ferry company from so doing; that this was an essential part of the interstate transportation which the state could not forbid, or burden by a privilege tax. See *Philadelphia & S. Mail S. S. Co. v. Pennsylvania*, 122 U. S. 326, 343, 30 L. Ed. 1200, 1204, 1 Interst. Com. R. 308, 7 Sup. Ct. 1118. Referring to foreign commerce, the court said in *Crutcher v. Kentucky*, 141 U. S. 47, 57, 35 L. Ed. 649, 652, 11 Sup. Ct. 851: "Would anyone pretend that a state legislature could prohibit a foreign corporation—an English or a French transportation company, for example—from coming into its borders and landing goods and passengers at its wharves, and soliciting goods and passengers for a return voyage without first obtaining a license from some state officer, and filing a sworn statement as to the amount of its capital stock paid in? And why not? Evidently because the matter is not within the province of state legislation, but within that of national legislation." Ferry transportation is placed upon the same footing in this respect by the holding in the *Gloucester Case* (*supra*, 114 U. S. pp. 203, 205, 5 Sup. Ct. 828, 29 L. Ed. 158), the

point of the decision being that the transportation was within the protection of the constitutional grant to Congress. "It matters not," said the court, "that the transportation is made in ferryboats, which pass between the states every hour of the day."

The fundamental principle involved has been applied by this court in recent decisions in a great variety of circumstances, and it must be taken to be firmly established that one otherwise enjoying full capacity for the purpose cannot be compelled to take out a local license for the mere privilege of carrying on interstate or foreign commerce. *Robbins v. Taxing Dist.*, 120 U. S. 489, 496, 30 L. Ed. 694, 697, 1 Interst. Com. R. 45, 7 Sup. Ct. 592; *Leloup v. Mobile*, 127 U. S. 640, 645, 32 L. Ed. 311, 313, 2 Interst. Com. R. 134, 8 Sup. Ct. 1380; *Stoutenburgh v. Hennick*, 129 U. S. 141, 148, 32 L. Ed. 637, 639, 9 Sup. Ct. 256; *McCall v. California*, 126 U. S. 104, 109, 34 L. Ed. 392, 3 Interst. Com. R. 181, 10 Sup. Ct. 881; *Norfolk & W. R. Co. v. Pennsylvania*, 136 U. S. 114, 34 L. Ed. 394, 3 Interst. Com. R. 178, 10 Sup. Ct. 958; *Crutcher v. Kentucky*, 141 U. S. 58, 35 L. Ed. 652, 11 Sup. Ct. 851; *Rearick v. Pennsylvania*, 203 U. S. 507, 51 L. Ed. 295, 27 Sup. Ct. 159; *Western U. Teleg. Co. v. Kansas*, 216 U. S. 1, 21, 54 L. Ed. 355, 363, 30 Sup. Ct. 190; *Pullman Co. v. Kansas*, 216 U. S. 56, 54 L. Ed. 378, 30 Sup. Ct. 232; *International Textbook Co. v. Pigg*, 217 U. S. 91, 109, 54 L. Ed. 678, 686, 27 L. R. A. (N. S.) 493, 30 Sup. Ct. 481, 18 Ann. Cas. 1103; *West v. Kansas Natural Gas Co.*, 221 U. S. 229, 260, 55 L. Ed. 716, 728, 35 L. R. A. (N. S.) 1193, 31 Sup. Ct. 564; *Bucks Stove & Range Co. v. Vickers*, 226 U. S. 205, 215, 57 L. Ed. 189, 192, 33 Sup. Ct. 41; *Crenshaw v. Arkansas*, 227 U. S. 389, 57 L. Ed. 565, 33 Sup. Ct. 294; *Minnesota Rate Cases (Simpson v. Shepard)* 230 U. S. 352, 400, 57 L. Ed. 1511, 1541, 48 L. R. A. (N. S.) 1151, 33 Sup. Ct. 729, Ann. Cas. 1916A, 18; *Barrett v. New York*, 232 U. S. 14, 31, 32, 58 L. Ed. 483, 34 Sup. Ct. 203.

Assuming that, by reason of the local considerations pertinent to the operation of ferries, there exists, in the absence of Federal action, a local protective power to prevent extortion in the rates charged for ferriage from the shore of the state, and to prescribe reasonable regulations necessary to secure good order and convenience, we think that the action of the city in the present case in requiring the appellee to take out a license, and to pay a license fee, for the privilege of transacting the business conducted at its wharf, was beyond the power which the state could exercise either directly or by delegation. In this view it is unnecessary to consider the question raised with respect to the treaty with Great Britain.

The decree restraining the enforcement of the ordinance in question as against the appellee is affirmed.

Affirmed.



## II. What Constitutes "Doing Business" in the State \*

### COMMERCIAL MUTUAL ACCIDENT COMPANY v. DAVIS.

(Supreme Court of United States, 1909. 213 U. S. 245, 29 Sup. Ct. 445, 53 L. Ed. 782.)

In Error to the Circuit Court of the United States for the Western District of Missouri to review a judgment overruling a motion to set aside service of process in an action against a foreign insurance company, and to dismiss the action for want of jurisdiction. Affirmed.

Mr. JUSTICE DAY delivered the opinion of the court:

This case presents a question of the jurisdiction of the circuit court of the United States to entertain a suit brought by Mary B. Davis, defendant in error, plaintiff below, against the Commercial Mutual Accident Company, plaintiff in error, defendant below. The case comes here upon a certificate involving the question whether the defendant company was duly served with process. The circuit court found that the service of summons was valid and sufficient to give it jurisdiction, and overruled a motion to set aside the service and dismiss the action for want of jurisdiction.

The suit was commenced by Mary B. Davis in the circuit court of Howard county, Missouri, and was removed to the circuit court of the United States for the central division of western Missouri by the defendant, a Pennsylvania corporation. The company made no appearance in the court below or in the state court, except for the purpose of raising the question of jurisdiction, and removing the case to the Federal court. Such proceedings did not amount to a general appearance in the suit. Goldey v. Morning News, 156 U. S. 518, 39 L. Ed. 517, 15 Sup. Ct. 559; Wabash Western R. Co. v. Brow, 164 U. S. 271, 41 L. Ed. 431, 17 Sup. Ct. 126.

The record contains a bill of exceptions, setting forth the testimony upon the question of jurisdiction. It appears that A. F. Davis, husband of the plaintiff, held a policy in the defendant company, issued August 6, 1896, in the sum of \$5,000, insuring against accidental death. On December 31, 1906, he received a gunshot wound, from which he died on the 4th of January, 1907. On January 7th, 1907, the insurance company was notified of the death. On January 14 and 15 one Dr. Mason, of Chicago, went to the city of Fayette, Missouri, the home of the plaintiff, and there made an investigation of the cause of death in defendant's behalf, and demanded an inspection of the body of the deceased, which demand was refused. Some correspondence ensued between the plaintiff and the defendant company, and, on February

\* For discussion of principles, see Clark on Corp. (3d Ed.) §§ 247-249.

20, a letter was written, signed by the plaintiff, which letter contained, among other things, the following:

"However, if you think it is right, you may send someone here to examine the body for you. Can't you also send someone authorized who could settle the claim here if your doctor found everything as reported, as most all of the claims have been paid, and I am very anxious to have the balance settled as soon as possible.

"Then, too, if I should want to compromise the claim in lieu of an examination, your agent would have power to settle it without any delay. Please let me know just when you will send someone, as I am thinking of going to St. Louis for a few days, and would like to be here when he comes, so let me know several days in advance."

To this letter the company replied by a letter written by its secretary at the Philadelphia office, that it would have its medical representative in Fayette with authority to make an adjustment. Afterwards, on February 27, Dr. Mason went to Fayette, having received a written letter of authority from the company, authorizing him to act on behalf of the company in the examination of the body of the deceased, which letter also authorized him to adjust the claim.

The testimony is not altogether in harmony as to what occurred at the meeting of February 27. It does appear that the representative of the plaintiff and Dr. Mason met and conferred upon the matter of compromising the claim, and that afterwards an offer was made by the plaintiff's representatives to proceed with an examination of the body of the deceased. Dr. Mason declined this offer until he could have another physician present; and, after some negotiation, a deputy sheriff appeared and served process upon Dr. Mason as agent of the company, upon a petition which had been prepared before his arrival, and which was filed in the case subsequently removed to the Federal court. There is also testimony tending to show that a physician was present, who was ready to assist in the examination of the body as a representative of the plaintiff.

The grounds of objection to the service in the case may be summarized to be: First, that Mason was not a person authorized to receive service of process on defendant's behalf; second, that, at the time the service was attempted, the defendant company was not engaged in the transaction of business in the state of Missouri; third, that Dr. Mason was enticed into the state of Missouri by the trick and device of the plaintiff; fourth, that the return of service did not disclose a valid service under the laws of the United States nor of the state of Missouri.

As to the service of summons, the statutes of Missouri provide (Revised Statutes of Missouri, 1899, vol. 1, § 570), as follows:

"A summons shall be executed, except as otherwise provided by law, either \* \* \* fourth, where defendant is a corporation or joint stock company, organized under the laws of any other state or country, and having an office or doing business in this state, by delivering a copy



of the writ and petition to any officer or agent of such corporation or company in charge of any office or place of business, or, if it have no office or place of business, then to any officer, agent, or employee in any county where such service may be obtained, and, when had in conformity with this subdivision, shall be deemed personal service against such corporation, and authorize the rendition of a general judgment against it."

Section 7992, vol. 2, Revised Statutes of Missouri, 1899:

"Service of summons in any action against an insurance company not incorporated under and by virtue of the laws of this state, and not authorized to do business in this state by the superintendent of insurance, shall, in addition to the mode prescribed in § 7991, be valid and legal and of the same force and effect as personal service on a private individual, if made by delivering a copy of the summons and complaint to any person within this state who shall solicit insurance on behalf of any such insurance corporation, or make any contract of insurance, or collects or receives any premium for insurance, or who adjusts or settles a loss, or pays the same for such insurance corporation, or in any manner aids or assists in doing either."

The sheriff returned the summons as follows:

"Executed the within writ in the county of Howard and state of Missouri, on the 27th day of February, a. d. 1907, by delivering a copy of the petition in this case hereto attached and a copy of this writ to Frank G. Mason, agent of the within-named defendant, the Commercial Mutual Accident Company, a corporation organized under the laws of the state of Pennsylvania, and doing business in the state, but having no office or place of business herein, and not incorporated under the laws of this state nor authorized to do business in this state, and while he, the said agent, was transacting business for the said defendant in our said county, and while he was adjusting or settling a loss on a policy of insurance for said defendant, or was aiding and assisting in so doing.

"George D. Gibson,

"Sheriff, Howard County, Missouri,

"By H. L. Hughes, Deputy."

In view of the fact that much of the business of the country is done by corporations having foreign charters and principal offices remote from states wherein they transact business, it has been found necessary to make provision for the service of summons upon local agents, in order to give jurisdiction to try controversies which have originated in such states. With this purpose in view, many states have provided that foreign corporations, in order to do business within the state, must make provision for service upon some local agent, or by authority conferred upon some state officer to accept service of summons. And but for such statutes and the authority given by the states to obtain service upon local agents, there could be no recovery upon the contracts of such companies, unless redress be sought in a distant state, where the company may happen to have its home office. Connecticut Mut. L.



Ins. Co. v. Spratley, 172 U. S. 602, 619, 43 L. Ed. 569, 575, 19 Sup. Ct. 308; Baltimore & O. R. Co. v. Harris, 12 Wall. 65, 83, 20 L. Ed. 354, 358.


In pursuance of this policy the state of Missouri has enacted the sections of its statutes providing for service upon the agents of insurance companies. In § 7992 it is provided, among other things, that service may be made by delivering a copy of the summons and complaint to any person within the state who shall solicit insurance on behalf of any insurance company, or make any contract of insurance, or who collects or receives any premium for insurance, or who adjusts or settles a loss or pays the same for such insurance corporation, or in any manner aids or assists in doing either. Under this section, in part, at least, the sheriff undertook to make service upon Dr. Mason. The record clearly discloses that Mason had authority to adjust and settle the loss which was the subject of the plaintiff's claim. It is true that the statute says that service may be upon "any person within the state \* \* \* who adjusts or settles the loss," etc. This language clearly has reference to the authority of the person whom the statute declares to be competent to receive service of summons, and the statute, in effect, provides that the person clothed with such power shall be capable of receiving service upon the corporation. The statute designing to reach one having the authority of the company for the purpose named, it is immaterial that the loss was not actually settled. This section (7992) is limited to the cases of companies not incorporated under the laws of the state, and not authorized to do such business within the state by the superintendent of insurance.

This law was in force when Dr. Mason came into the state, clothed with full authority to settle the loss. The company must be presumed to have acted with knowledge of this statute. The company could only be served with process through some agent. It was competent for the state, keeping within lawful bounds, to designate the agent upon whom process might be served. It chose to enact a statute providing that an agent competent by authority of the company to settle and adjust losses should be competent to represent the company for the service of process. When the company sent such an agent into Missouri, by force of the statute he is presumed to represent the company for the purpose of service, and to be vested with authority in respect to such service so far as to make it known to the foreign corporation thus coming within the state and subjecting itself to its laws. Lafayette Ins. Co. v. French, 18 How. 404, 408, 15 L. Ed. 451, 453.

It is not necessary that express authority to receive service of process be shown. The law of the state may designate an agent upon whom service may be made, if he be one sustaining such relation to the company that the state may designate him for that purpose, exercising legislative power within the lawful bounds of due process of law. This was held in effect in Connecticut Mut. L. Ins. Co. v. Spratley, 172 U. S. 602, 43 L. Ed. 569, 19 Sup. Ct. 308.

We think the state did not exceed its power and did no injustice to the corporation by requiring that, when it clothed an agent with authority to adjust or settle the loss, such agent should be competent to receive notice, for the company, of an action concerning the same.

It is further contended that the defendant company was not doing business within the state of Missouri. That it is essential, in order to obtain jurisdiction over a foreign corporation having, as in the case at bar, neither property nor agent in the state, that it be doing business in the state, is settled by numerous decisions of this court. *St. Clair v. Cox*, 106 U. S. 350, 27 L. Ed. 222, 1 Sup. Ct. 354; *Goldey v. Morning News*, 156 U. S. 518, 39 L. Ed. 517, 15 Sup. Ct. 559; *Barrow S. S. Co. v. Kane*, 170 U. S. 100, 42 L. Ed. 964, 18 Sup. Ct. 526; *Connecticut Mut. L. Ins. Co. v. Spratley*, supra; *Conley v. Mathieson v. Alkali Works*, 190 U. S. 406, 47 L. Ed. 1113, 23 Sup. Ct. 728; *Pennsylvania Lumbermen's Mut. F. Ins. Co. v. Meyer*, 197 U. S. 407, 49 L. Ed. 810, 25 Sup. Ct. 483; *Peterson v. Chicago, R. I. & P. R. Co.*, 205 U. S. 364, 51 L. Ed. 841, 27 Sup. Ct. 513.

 Was the defendant doing business in the state of Missouri? The record discloses, and the court has found, that it had other insurance policies outstanding in the state of Missouri. Upon these policies undoubtedly premiums were paid, and it was the right of the company to investigate losses thereunder, to have an examination of the body of the deceased in proper cases, and to do whatever might be necessary to an adjustment or payment of any loss. The record shows that the company sent Dr. Mason to Fayette to investigate the loss sued for in this case, and later, and at the time of the service of the process, Mason was in Missouri with full authority to settle the loss in controversy.

Previous cases in this court have not defined the extent of the business necessary to the presence of a foreign corporation in the state for the purpose of a valid service; it is sufficient if it is doing business therein. We are of opinion that the finding of the court in this case is supported by testimony, and that the corporation was doing business in Missouri.

It is urged that it clearly appears from the testimony in this case that Dr. Mason was sent into the state of Missouri because of the fraud and artifice of the plaintiff, and that in such case the law will not permit a service of summons to stand. It is undoubtedly true that if a person is induced by artifice or fraud to come within the jurisdiction of the court for the purpose of procuring service of process, such fraudulent abuse of the writ will be set aside upon proper showing. *Fitzgerald & M. Constr. Co. v. Fitzgerald*, 137 U. S. 98, 34 L. Ed. 608, 11 Sup. Ct. 36. "The fraud of the plaintiff," says the counsel for the plaintiff in error, "consisted in inducing the company, by artifice, to confer upon Dr. Mason authority to compromise the suit."

Upon the testimony before the court, the circuit court reached the conclusion that the company was not induced by fraud or artifice to send Dr. Mason to the state of Missouri. This court has jurisdiction to



review, under § 5 of the act of March 3, 1891 [26 Stat. at L. 827, chap. 517, U. S. Comp. Stat. 1901, p. 549], cases in which the question of jurisdiction alone is involved, and which are duly certified here for decision. And where the decision of the court below is clearly wrong, even upon a question of fact, it may be set aside under the power conferred by the statute upon this court. We think this is the effect of the reasoning in *Goldney v. Morning News*, supra; and *Mexican C. R. Co. v. Pinkney*, 149 U. S. 194, 37 L. Ed. 699, 13 Sup. Ct. 859.

It is contended by counsel for the plaintiff in error that the evidence is undisputed, and clearly demonstrates the fraudulent conduct of the plaintiff in obtaining service in this case. But we are not prepared, on this question of fact, to say that the court below committed plain error. The court might have found upon the testimony that there was a bona fide attempt to settle the controversy between the parties, and that it was only when they failed to settle that service of summons was made upon Mason, as the agent of the company. There is testimony tending to show that both parties expected an adjustment of the claim to be made at this meeting, which was held for that purpose. There is testimony from which it might be inferred that there was a bona fide offer to permit an examination at that time of the remains of the deceased. We do not feel authorized to find, as against the testimony set forth in the bill of exceptions, and the finding of the court below, that the purpose in writing the letter of February 20, and procuring authority to be conferred upon Dr. Mason to settle the case, and to come into the state of Missouri for that purpose, was a mere fraudulent scheme to obtain service upon the insurance company.

As the sole question before us pertains to the sufficiency of the service under the facts disclosed, we reach the conclusion that the judgment of the Circuit Court must be affirmed.

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### III. Actions by and against Foreign Corporations \*

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#### ST. CLAIR v. COX.

(Supreme Court of United States, 1882. 106 U. S. 350, 1 Sup. Ct. 354, 27 L. Ed. 222.)

Error to the Circuit Court of the United States for the Eastern District of Michigan.

The facts are stated in the opinion of the court.

Mr. JUSTICE FIELD delivered the opinion of the court.

This action was brought by the plaintiff in the court below, to recover the amount due on two promissory notes of the defendants, each

\* For discussion of principles, see Clark on Corp. (3d Ed.) §§ 250-254.



for the sum of \$2500, bearing date on the 2d of August, 1877, and payable five months after date, to the order of the Winthrop Mining Company, at the German National Bank, in Chicago, with interest at the rate of seven per cent. per annum.

To the action the defendants set up various defenses, and, among others, substantially these: That the consideration of the notes had failed; that they were given, with two others of like tenor and amount, to the Winthrop Mining Company, a corporation created under the laws of Illinois, in part payment for ore and other property sold to the defendants upon a representation as to its quantity, which proved to be incorrect; that only a portion of the quantity sold was ever delivered, and that the value of the deficiency exceeded the amount of the notes in suit; that at the commencement of the action, and before the transfer of the notes to the plaintiff, the Winthrop Mining Company was indebted to the defendants in a large sum, viz., \$10,000, upon a judgment recovered by them in the Circuit Court of Marquette County in the State of Michigan, and that the notes were transferred to him after their maturity and dishonor, and after he had notice of the defenses to them.

On the trial, evidence was given by the defendants tending to show that the plaintiff was not a bona fide holder of the notes for value. A certified copy of that judgment was also produced by them and offered in evidence; but on his objection that it had not been shown that the court had obtained jurisdiction of the parties, it was excluded, and to the exclusion an exception was taken. The jury found for him for the full amount claimed; and judgment having been entered thereon, the defendants brought the case here for review. The ruling of the court below in excluding the record constitutes the only error assigned.

The judgment of the Circuit Court in Michigan was rendered in an action commenced by attachment. If the plaintiffs in that action were, at its commencement, residents of the State, of which some doubt is expressed by counsel, the jurisdiction of the court, under the writ, to dispose of the property attached, cannot be doubted, so far as was necessary to satisfy their demand. No question was raised as to the validity of the judgment to that extent.

The objection to it as evidence was that the amount rendered was an existing obligation or debt against the company. If the court had not acquired jurisdiction over the company, the judgment established nothing as to its liability, beyond the amount which the proceeds of the property discharged. There was no appearance of the company in the action, and judgment against it was rendered for \$6,450 by default. The officer, to whom the writ of attachment was issued, returned that, by virtue of it, he had seized and attached certain specified personal property of the defendant, and had also served a copy of the writ, with a copy of the inventory of the property attached, on the defendant, "by delivering the same to Henry J. Colwell, Esq., agent of the said Winthrop Mining Company, personally, in said county."

The laws of Michigan provide for attaching property of absconding, fraudulent, and non-resident debtors and of foreign corporations. They require that the writ issued to the sheriff, or other officer by whom it is to be served, shall direct him to attach the property of the defendant, and to summon him if he be found within the county, and also to serve on him a copy of the detachment and of the inventory of the property attached. They also declare that where a copy of the writ of attachment has been personally served on the defendant, the same proceedings may be had thereon in the suit in all respects as upon the return of an original writ of summons personally served where suit is commenced by such summons. 2 Comp. Laws Mich. 1871, §§ 6397 and 6413.

They also provide, in the chapter regulating proceedings by and against corporations, that "suits against corporations may be commenced by original writ of summons, or by declaration, in the same manner that personal actions may be commenced against individuals, and such writ, or a copy of such declaration, in any suit against a corporation, may be served on the presiding officer, the cashier, the secretary, or the treasurer thereof; or, if there be no such officer, or none can be found, such service may be made on such other officer or member of such corporation, or in such other manner as the court in which such suit is brought may direct;" and that "in suits commenced by attachment in favor of a resident of this State against any corporation created by or under the laws of any State, government, or country, if a copy of such attachment and of the inventory of property attached shall have been personally served on any officer, member, clerk, or agent of such corporation within this State, the same proceedings shall be thereupon had, and with like effect, as in case of an attachment against a natural person, which shall have been returned served in like manner upon the defendant." 2 Comp. Laws Mich. 1871, §§ 6544 and 6550.

The courts of the United States only regard judgments of the State courts establishing personal demands as having validity or as important verity where they have been rendered upon personal citation of the party, or what is the same thing, of those empowered to receive process for him, or upon his voluntary appearance.

In *Pennoyer v. Neff* we had occasion to consider at length the manner in which State courts can acquire jurisdiction to render a personal judgment against non-residents which would be received as evidence in the Federal Courts; and we held that personal service of citation on the party or his voluntary appearance was, with some exceptions, essential to the jurisdiction of the court. The exceptions related to those cases where proceedings are taken in a State to determine the status of one of its citizens towards a non-resident, or where a party has agreed to accept a notification to others or service on them as citation to himself. 95 U. S. 714, 24 L. Ed. 565.

The doctrine of that case applies, in all its force, to personal judg-

ments of State courts against foreign corporations. The courts rendering them must have acquired jurisdiction over the party by personal service or voluntary appearance, whether the party be a corporation or a natural person. There is only this difference: a corporation being an artificial being, can act only through agents, and only through them can be reached, and process must, therefore, be served upon them. In the State where a corporation is formed it is not difficult to ascertain who are authorized to represent and act for it. Its charter or the statutes of the State will indicate in whose hands the control and management of its affairs are placed. Directors are readily found, as also the officers appointed by them to manage its business. But the moment the boundary of the State is passed difficulties arise; it is not so easy to determine who represent the corporation there, and under what circumstances service on them will bind it.

Formerly it was held that a foreign corporation could not be sued in an action for the recovery of a personal demand outside of the State by which it was chartered. The principle that a corporation must dwell in the place of its creation, and cannot, as said by Mr. Chief Justice Taney, migrate to another sovereignty, coupled with the doctrine that an officer of the corporation does not carry his functions with him when he leaves his state, prevented the maintenance of personal actions against it. There was no mode of compelling its appearance in the foreign jurisdiction. Legal proceedings there against it were, therefore, necessarily confined to the disposition of such property belonging to it as could be there found; and to authorize them legislation was necessary.

In *McQueen v. Middletown Manufacturing Co.*, decided in 1819, the Supreme Court of New York, in considering the question whether the law of that State authorized an attachment against the property of a foreign corporation, expressed the opinion that a foreign corporation could not be sued in the State, and gave as a reason that the process must be served on the head or principal officer within the jurisdiction of the sovereignty where the artificial body existed; observing that if the president of a bank went to New York from another State he would not represent the corporation there; and that "his functions and his character would not accompany him when he moved beyond the jurisdiction of the government under whose laws he derived this character." 16 Johns. (N. Y.) 5. The opinion thus expressed was not, perhaps, necessary to the decision of the case, but nevertheless it has been accepted as correctly stating the law. It was cited with approval by the Supreme Court of Massachusetts, in 1834, in *Peckham v. North Parish in Haverhill*, the court adding that all foreign corporations were without the jurisdiction of the process of the courts of the Commonwealth. 16 Pick. (Mass.) 274. Similar expressions of opinion are found in numerous decisions, accompanied sometimes with suggestions that the doctrine might be otherwise if the foreign corporation sent its officer



to reside in the State and transact business there on its account. *Libbey v. Hodgdon*, 9 N. H. 394; *Moulin v. Trenton Insurance Co.*, 24 N. J. Law, 222.

This doctrine of the exemption of a corporation from suit in a State other than that of its creation was the cause of much inconvenience, and often of manifest injustice. The great increase in the number of corporations of late years, and the immense extent of their business, only made this inconvenience and injustice more frequent and marked. Corporations now enter into all the industries of the country. The business of banking, mining, manufacturing, transportation, and insurance is almost entirely carried on by them, and a large portion of the wealth of the country is in their hands. Incorporated under the laws of one State, they carry on the most extensive operations in other States. To meet and obviate this inconvenience and injustice, the legislatures of several States interposed, and provided for service of process on officers and agents of foreign corporations doing business therein. Whilst the theoretical and legal view, that the domicile of a corporation is only in the State where it is created, was admitted, it was perceived that when a foreign corporation sent its officers and agents into other States and opened offices, and carried on its business there, it was, in effect, as much represented by them there as in the State of its creation. As it was protected by the laws of those States, allowed to carry on its business within their borders, and to sue in their courts, it seemed only right that it should be held responsible in those courts to obligations and liabilities there incurred.

All that there is in the legal residence of a corporation in the State of its creation consists in the fact that by its laws the corporators are associated together and allowed to exercise as a body certain functions, with a right of succession in its members. Its officers and agents constitute all that is visible of its existence; and they may be authorized to act for it without as well as within the State. There would seem, therefore, to be no sound reason why, to the extent of their agency, they should not be equally deemed to represent it in the States for which they are respectively appointed when it is called to legal responsibility for their transactions.

The case is unlike that of suits against individuals. They can act by themselves, and upon them process can be directly served, but a corporation can only act and be reached through agents. Serving process on its agents in other States, for matters within the sphere of their agency, is, in effect, serving process on it, as much so as if such agents resided in the State where it was created.

A corporation of one State cannot do business in another State without the latter's consent, express or implied, and that consent may be accompanied with such conditions as it may think proper to impose. As said by this court in *Lafayette Insurance Co. v. French*, "These conditions must be deemed valid and effectual by other States

and by this court, provided they are not repugnant to the Constitution or laws of the United States, or inconsistent with those rules of public law which secure the jurisdiction and authority of each State from encroachment by all others, or that principle of natural justice which forbids condemnation without opportunity for defence." 18 How. 404, 407, 15 L. Ed. 451; *Paul v. Virginia*, 8 Wall. 168, 19 L. Ed. 357.

The State may, therefore, impose as a condition upon which a foreign corporation shall be permitted to do business within her limits, that it shall stipulate that in any litigation arising out of its transactions in the State, it will accept as sufficient the service of process on its agents or persons specially designated; and the condition would be eminently fit and just. And such condition and stipulation may be implied as well as expressed. If a State permits a foreign corporation to do business within her limits, and at the same time provides that in suits against it for business there done, process shall be served upon its agents, the provision is to be deemed a condition of the permission; and corporations that subsequently do business in the State are to be deemed to assent to such condition as fully as though they had specially authorized their agents to receive service of the process. Such condition must not, however, encroach upon that principle of natural justice which requires notice of a suit to a party before he can be bound by it. It must be reasonable, and the service provided for should be only upon such agents as may be properly deemed representatives of the foreign corporation. The decision of this court in *Lafayette Insurance Co. v. French*, to which we have already referred, sustains these views.

The State of Michigan permits foreign corporations to transact business within her limits. Either by express enactment, as in the case of insurance companies, or by her acquiescence, they are as free to engage in all legitimate business as corporations of her own creation. Her statutes expressly provide for suits being brought by them in her courts; and for suits by attachment being brought against them in favor of residents of the State. And in these attachment suits they authorize the service of a copy of the writ of attachment with a copy of the inventory of the property attached, on "any officer, member, clerk, or agent of such corporation" within the State, and give to a personal service of a copy of the writ and of the inventory on one of these persons the force and effect of personal service of a summons on a defendant in suits commenced by summons.

It thus seems that a writ of foreign attachment in the State is made to serve a double purpose,—as a command to the officer to attach property of the corporation, and as a summons to the latter to appear in the suit. We do not, however, understand the laws as authorizing the service of a copy of the writ, as a summons, upon an agent of a foreign corporation, unless the corporation be engaged in business in

the State, and the agent be appointed to act there. We so construe the words "agent of such corporation within this State." They do not sanction service upon an officer or agent of the corporation who resides in another State, and is only casually in the State, and not charged with any business of the corporation there. The decision in *Newell v. Great Western Railway Co.*, reported in the 19th of Michigan Reports, page 336, supports this view, although that was the case of an attempted service of a declaration as the commencement of the suit. The defendant was a Canadian corporation owning and operating a railroad from Suspension Bridge in Canada to the Detroit line at Windsor, and carrying passengers in connection with the Michigan Central Railroad Company, upon tickets sold by such companies respectively. The suit was commenced in Michigan, the declaration alleging a contract by the defendant to carry the plaintiff over its road, and its violation of the contract by removing him from its cars at an intermediate station. The declaration was served upon Joseph Price, the treasurer of the corporation, who was only casually in the State. The corporation appeared specially to object to the jurisdiction of the court, and pleaded that it was a foreign corporation, and had no place of business or agent or officer in the State, or attorney to receive service of legal process, or to appear for it; and that Joseph Price was not in the State at the time of service on him on any official business of the corporation. The plaintiff having demurred to this plea, the court held the service insufficient. "The corporate entity," said the court, "could by no possibility enter the State, and it could do nothing more in that direction than to cause itself to be represented here by its officers or agents. Such representation would, however, necessarily imply something more than the mere presence here of a person possessing when in Canada, the relation to the company of an officer or agent. To involve the representation of the company here, the supposed representative would have to hold or enjoy in this State an actual present official or representative status. He would be required to be here as an agent or officer of the corporation, and not as an isolated individual. If he should drop the official or representative character at the frontier, if he should bring that character no further than the territorial boundary of the government to whose laws the corporate body itself, and consequently the official positions of its officers also, would be constantly indebted for existence, it could not, with propriety, be maintained that he continued to possess such character by force of our statute. Admitting, therefore, for the purpose of this suit that in given cases the foreign corporation would be bound by service on its treasurer in Michigan, this could only be so when the *treasurer*, the then *official*, the officer then in a manner impersonating the company, should be served. Joseph Price was not here as the treasurer of the defendants. He did not then represent them. His act in coming was not the act of the company, nor was his remaining the business or act of any



besides himself. He had no principal, and he was not an agent. He had no official status or representative character in this State" (19 Mich. p. 344).

✓ According to the view thus expressed by the Supreme Court of Michigan, service upon an agent of a foreign corporation will not be deemed sufficient, unless he represents the corporation in the State. This representation implies that the corporation does business, or has business, in the State for the transaction of which it sends or appoints an agent there. If the agent occupies no representative character with respect to the business of the corporation in the State, a judgment rendered upon service on him would hardly be considered in other tribunals as possessing any probative force. In a case where similar service was made in New York upon an officer of a corporation of New Jersey accidentally in the former State, the Supreme Court of New Jersey said, that a law of another State which sanctioned such service upon an officer accidentally within its jurisdiction was "so contrary to natural justice and to the principles of international law, that the courts of other States ought not to sanction it." *Moulin v. Trenton Insurance Co.*, 24 N. J. Law, 222, 234.

Without considering whether authorizing service of a copy of a writ of attachment as a summons on some of the persons named in the statute—a member, for instance, of the foreign corporation, that is, a mere stockholder—is not a departure from the principle of natural justice mentioned in *Lafayette Insurance Co. v. French*, which forbids condemnation without citation, it is sufficient to observe that we are of opinion that when service is made within the State upon an agent of a foreign corporation, it is essential, in order to support the jurisdiction of the court to render a personal judgment, that it should appear somewhere in the record—either in the application of the writ, or accompanying its service, or in the pleadings or the finding of the court—that the corporation was engaged in business in the State. The transaction of business by the corporation in the State, general or special, appearing, a certificate of service by the proper officer on a person who is its agent there would, in our opinion, be sufficient *prima facie* evidence that the agent represented the company in the business. It would then be open, when the record is offered as evidence in another State, to show that the agent stood in no representative character to the company, that his duties were limited to those of a subordinate employé, or to a particular transaction, or that his agency had ceased when the matter in suit arose.

In the record, a copy of which was offered in evidence in this case, there was nothing to show so far as we can see, that the Winthrop Mining Company was engaged in business in the State when service was made on Colwell. The return of the officer, on which alone reliance was placed to sustain the jurisdiction of the State court, gave

no information on the subject. It did not, therefore, appear even prima facie that Colwell stood in any such representative character to the company as would justify the service of a copy of the writ on him. The certificate of the sheriff, in the absence of this fact in the record, was insufficient to give the court jurisdiction to render a personal judgment against the foreign corporation. The record was, therefore, properly excluded.

Judgment affirmed.

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### RIVERSIDE & DAN RIVER COTTON MILLS v. MENEFEER.

(Supreme Court of United States, 1915. 237 U. S. 189, 35 Sup. Ct. 579, 59 L. Ed. 910.)

In Error to the Supreme Court of the State of North Carolina to review a judgment which affirmed a judgment of the Superior Court of Alamance County, in that state, against a foreign corporation, rendered upon service on a resident director. Reversed.

See same case below, 161 N. C. 164, 76 S. E. 741.

Mr. CHIEF JUSTICE WHITE delivered the opinion of the court:

The plaintiff in error, a corporation called hereafter the Riverside Mills, was sued in North Carolina by the defendant in error, a resident of that state, to recover for personal injuries alleged to have been suffered by him while working in Virginia as an employé in a cotton mill operated by the Riverside Mills. The summons directed to the corporation was returned by the sheriff served as follows: "By reading and leaving a copy of the within summons with Thos. B. Fitzgerald, a director of the defendant corporation." The Riverside Mills filed a special appearance and motion to dismiss in which it prayed for the striking out of the return of service for the reason that "the defendant is a foreign corporation, not doing business in North Carolina, and has not been domesticated, and has no agent upon whom service can be made, and that the service of the summons is invalid and does not amount to due process of law as against this defendant." This motion was supported by an affidavit of a person styling himself secretary and treasurer of the company, stating the facts to be that the corporation was a Virginia one, had its place of business in Virginia, carried on its factory there, had never transacted business in North Carolina, had no property there, and that the person upon whom service was made, although he was a director of the corporation and was a resident of North Carolina, had never transacted any business in that state for the corporation. The motion to strike out was refused, although the court found the facts to be in accordance with the statement made in the motion and in the affidavit. The defendant answered. There was a trial to a jury, and despite the insistence upon the invalidity of the summons, there was a verdict against the Riverside Mills to which it prosecuted error to the supreme court of North

Carolina. For the purpose of that review an agreed case was made in which the facts were found to be as stated in the affidavit supporting the motion to strike out, and in considering the case the court below, stating the same facts, reviewed the ruling of the trial court upon that premise.

Coming first to consider the statutes of North Carolina and various decisions of that state construing and applying them, the court held that as the plaintiff was a resident of the state, and the director upon whom the summons was served also resided in the state, the summons was authorized, wholly irrespective of whether the foreign corporation had transacted any business in the state, had any property in the state, or whether the resident director was carrying on business for the corporation in North Carolina or had done so. The court came then to consider decisions of this court, which it deemed related to the question under consideration, for the purpose of testing how far the due process clause relied upon operated from a Federal point of view, that is, the Constitution of the United States, to dominate and modify, if at all, the state rule. In doing so reference was made to the ruling in *Goldey v. Morning News*, 156 U. S. 518, 39 L. Ed. 517, 15 Sup. Ct. 559, and *Conley v. Mathieson Alkali Works*, 190 U. S. 406, 47 L. Ed. 1113, 23 Sup. Ct. 728, in the first of which it was held that there was no basis for asserting jurisdiction as the result of service of process on the president of a foreign corporation in a state where he was temporarily present, and where the corporation did no business, had no property, and where the president was transacting no business for the corporation in the state where he was served; and in the second of which, under like conditions, the same conclusion was reached where the service was made on a director of a foreign corporation residing in the state where the suit was brought. After briefly reviewing these cases, which were both decided in courts of the United States on removal from state courts, and directing attention to the fact that in the *Goldey Case* it was observed, "Whatever effect a constructive service may be allowed in the courts of the same government, it cannot be recognized as valid by the courts of any other government," and that the same observation was reiterated in the opinion in the *Conley Case*, it was in effect decided that from the point of view of the Constitution of the United States the due process clause relied upon did not control the state law so as to prevent the taking of jurisdiction under the summons for the purpose of entering a judgment, whatever effect the due process clause might have upon the power to enforce the judgment when rendered. The court said: "Under our decisions above quoted, and upon which the plaintiff relied in bringing his action, the service is sufficient for a valid judgment, at least, within our jurisdiction." Concerning the judgment of affirmance which it awarded, the court further said: "What opportunity or method the plaintiff may have to enforce his judgment is not before us now for consideration." Two members of the court dissented



upon the ground that the decisions of this court, which were referred to in the opinion of the court, clearly established that there was no power to render the judgment, and that the same conclusion was required as the result of the following additional cases in this court: *Old Wayne Mut. Life Asso. v. McDonough*, 204 U. S. 8, 51 L. Ed. 345, 27 Sup. Ct. 236; *Kendall v. American Automatic Loom Co.*, 198 U. S. 477, 49 L. Ed. 1133, 25 Sup. Ct. 768; *Connecticut Mut. L. Ins. Co. v. Spratley*, 172 U. S. 602, 43 L. Ed. 569, 19 Sup. Ct. 308; *St. Clair v. Cox*, 106 U. S. 350, 27 L. Ed. 222, 1 Sup. Ct. 354; *Barrow S. S. Co. v. Kane*, 170 U. S. 100, 42 L. Ed. 964, 18 Sup. Ct. 526; *Fitzgerald & M. Constr. Co. v. Fitzgerald*, 137 U. S. 98, 34 L. Ed. 608, 11 Sup. Ct. 36. To the judgment thus rendered (161 N. C. 164, 76 S. E. 741) this writ of error was prosecuted.

Was error committed in deciding that, consistently with the due process clause of the 14th Amendment, there was jurisdiction to enter against the defendant a money judgment, even although by implied reservation its effect was limited to the confines of the state, and the extent to which the judgment as so rendered was susceptible of being executed was left open for future consideration when the attempt to enforce the judgment would give rise to the necessity for its solution?

That to condemn without a hearing is repugnant to the due process clause of the 14th Amendment needs nothing but statement. Equally well settled is it that the courts of one state cannot, without a violation of the due process clause, extend their authority beyond their jurisdiction so as to condemn the resident of another state when neither his person nor his property is within the jurisdiction of the court rendering the judgment, since that doctrine was long ago established by the decision in *Pennoyer v. Neff*, 95 U. S. 714, 24 L. Ed. 565, and has been without deviation upheld by a long line of cases, a few of the leading ones being cited in the margin.† And that a corporation, no more than an individual, is subject to be condemned without a hearing, or may be subjected to judicial power in violation of the fundamental principles of due process as recognized in *Pennoyer v. Neff*, is also established by the cases referred to and many others.

Whatever long ago may have been the difficulty in applying the principles of *Pennoyer v. Neff* to corporations, that is, in determining when, if at all, a corporation created by the laws of one state could be sued in the courts of another sovereignty, because of the conception that, as an ideal being, a corporation could not migrate and its officers, in going into another sovereignty, did not take with them their

† *St. Clair v. Cox*, 106 U. S. 350, 27 L. Ed. 222, 1 Sup. Ct. 354; *Freeman v. Alderson*, 119 U. S. 185, 30 L. Ed. 372, 7 Sup. Ct. 165; *Wilson v. Seligman*, 144 U. S. 41, 36 L. Ed. 338, 12 Sup. Ct. 541; *Scott v. McNeal*, 154 U. S. 34, 38 L. Ed. 896, 14 Sup. Ct. 1108; *Caledonian Coal Co. v. Baker*, 196 U. S. 432, 49 L. Ed. 540, 25 Sup. Ct. 375; *Haddock v. Haddock*, 201 U. S. 562, 50 L. Ed. 867, 26 Sup. Ct. 525, 5 Ann. Cas. 1; *Clark v. Wells*, 203 U. S. 164, 51 L. Ed. 138, 27 Sup. Ct. 43; *Hunter v. Mutual Reserve L. Ins. Co.*, 218 U. S. 573, 54 L. Ed. 1155, 30 L. R. A. (N. S.) 686, 31 Sup. Ct. 127.

power to represent the corporation, such difficulty ceased to exist with the decision of this court rendered more than thirty years ago in *St. Clair v. Cox*, 106 U. S. 350, 27 L. Ed. 222, 1 Sup. Ct. 354, which, together with the leading cases which have followed it, has been already referred to. And the doctrine which they uphold with virtual unanimity has been upheld by the courts of last resort of most of the states in such a number of cases as to render their citation unnecessary. Without restating the *St. Clair Case* or the leading cases which have followed and applied it, we content ourselves with saying that it results from them that it is indubitably established that the courts of one state may not, without violating the due process clause of the 14th Amendment, render a judgment against a corporation organized under the laws of another state where such corporation has not come into such state for the purpose of doing business therein, or has done no business therein, or has no property therein, or has no qualified agent therein upon whom process may be served; and that the mere fact that an officer of a corporation may temporarily be in the state or even permanently reside therein, if not there for the purpose of transacting business for the corporation, or vested with authority by the corporation to transact business in such state, affords no basis for acquiring jurisdiction or escaping the denial of due process under the 14th Amendment which would result from decreeing against the corporation upon a service had upon such an officer under such circumstances. And this makes clear why there is no ground for assuming that there was conflict between the ruling in *Goldey v. Morning News*, supra, where it was held that jurisdiction could not be acquired over a corporation of one state in another and different state by service on the president of the corporation temporarily in such state, and the ruling in *Conley v. Mathieson Alkali Works*, supra, that jurisdiction could not be acquired under the same circumstances by service on a director permanently residing in the other state, since both cases were rested upon the basis that not the character of the residence, but the character and power of the one served as an agent of the corporation, was the test of the right to acquire jurisdiction.

It is self-evident that the application of these settled principles establishes the error of the decision of the court below unless it be that the distinction upon which the court acted be well founded; that is, that the enforcement of due process under the 14th Amendment was without influence upon the power to render the judgment, since that limitation was pertinent only to the determination of when and how the judgment, after it was rendered, could be enforced. But this doctrine, while admitting the operation of the due process clause, simply declines to make it effective. That is to say, it recognizes the right to invoke the protection of the clause, but denies its remedial efficiency by postponing its operation, and thus permitting that to be done which, if the constitutional guaranty were applied, would be absolutely prohibited. But the obvious answer to the proposition is that wherever

a provision of the Constitution is applicable, the duty to enforce it is imperative and all-embracing, and no act which it forbids may therefore be permitted. If the suggestion be that although, under the jurisdiction which was exerted, in form a money judgment was entered, as no harm could result until the execution, therefore no occasion for applying the due process clause arose, it suffices to say that the proposition but assumes the issue for decision, since the very act of fixing by judicial action without a hearing a sum due, even although the method of execution be left open, would be, in and of itself, a manifestation of power repugnant to the due process clause.

It is, however, unnecessary to pursue the subject from an original point of view, since in *Pennoyer v. Neff*, supra, among other things it was said that "proceedings in a court of justice to determine the personal rights and obligations of parties over whom the court has no jurisdiction do not constitute due process of law." And see *Connecticut Mut. L. Ins. Co. v. Spratley*, 172 U. S. 602, 43 L. Ed. 569, 19 Sup. Ct. 308, where these principles were treated as self-evident. It is true that in most of the decided cases questions concerning judgments rendered without a hearing under the circumstances here disclosed have arisen from attempts to enforce such judgments in jurisdictions other than the one wherein they were rendered, presumably because the defense of want of due process was not made until the judgments had been entered and an effort to enforce them was made. But the fact that because, unobservedly or otherwise, judgments have been rendered in violation of the due process clause, and their enforcement has been refused under the full faith and credit clause, affords no ground for refusing to apply the due process clause and preventing that from being done which is by it forbidden, and which, if done, would be void and not entitled to enforcement under the full faith and credit clause. The two clauses are harmonious, and because the one may be applicable to prevent a void judgment being enforced affords no ground for denying efficacy to the other in order to permit a void judgment to be rendered.

Reversed.

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#### BAGDON v. PHILADELPHIA & READING COAL & IRON CO.

(Court of Appeals of New York, 1916. 217 N. Y. 432, 111 N. E. 1075.)

Appeal from Supreme Court, Appellate Division, Second Department.

Action by George Bagdon against the Philadelphia & Reading Coal & Iron Company. From an order of the Appellate Division (170 App. Div. 594, 156 N. Y. Supp. 647), affirming an order setting aside the service of summons, plaintiff appeals, and the Appellate Division cer-



tifies a question. Order reversed, and question certified answered in the negative.

The Appellate Division certified the following question: "Should service of the summons in this action upon the defendant be set aside?"

CARDOZO, J. The plaintiff is a resident of this state; the defendant, a Pennsylvania corporation; and the cause of action, a breach of contract. The plaintiff, while working for the defendant in Pennsylvania, was injured through the defendant's negligence. A contract was then made to compensate him for his injuries. The plaintiff complains that this contract has been broken. He has served the summons on an agent designated by the defendant as "a person upon whom process against the corporation may be served within the state." General Corporation Law, § 16 (Consol. Laws, c. 23). The defendant concedes that it is engaged in business in New York. It concedes that its appointment of an agent has never been revoked. It insists, however, that his agency must be limited to actions which arise out of the business transacted in New York. It says that any other construction would do violence to its rights under the federal Constitution. But the plaintiff's cause of action has no relation to business transacted in New York. His cause of action owes its origin to business transacted in Pennsylvania. The defendant says that for this reason the service is invalid; and both at the Special Term and at the Appellate Division its position has been sustained.

Two cases in the Supreme Court of the United States are said to be authority for that conclusion. They are *Old Wayne Life Ass'n v. McDonough*, 204 U. S. 8, 27 Sup. Ct. 236, 51 L. Ed. 345, and *Simon v. Southern Railway Co.*, 236 U. S. 115, 35 Sup. Ct. 255, 59 L. Ed. 492. In neither case had any agent for the service of process been appointed. In each the court was dealing with the consequences that attach to the refusal to appoint an agent. There was no attempt to decide anything but the precise question involved. In *Old Wayne Life Ass'n v. McDonough*, *supra*, an action was brought in Pennsylvania against an insurance company organized in Indiana. The laws of Pennsylvania provide that no foreign insurance company shall do business in that state until it has filed a stipulation that any legal process affecting the company may be served either on a designated agent or on the insurance commissioner, with the same effect as if served personally on the company. The *Old Wayne Life Association* did business in Pennsylvania; but it did not file the stipulation. A creditor sued it on a claim having no relation to its Pennsylvania business, and served the insurance commissioner. This service was held invalid. The court said that, if the cause of action had relation to business transacted in Pennsylvania, the insurance company would be estopped to take advantage of its failure to file the stipulation required by the statute. Even though it had not consented to be bound by service on a public officer, it would in such a situation be charged with the same consequences as

if it had consented. But the court refused to extend the estoppel to a case where the transaction of business in Pennsylvania had no relation to the cause of action. In such a case it held that: "The company had the right to show the truth, and the truth was that it had not given its consent. While the highest considerations of public policy demand that an insurance corporation, entering a state in defiance of a statute which lawfully prescribes the terms upon which it may exert its powers there, should be held to have assented to such terms as to business there transacted by it, it would be going very far to imply, and we do not imply, such assent as to business transacted in another state, although citizens of the former state may be interested in such business." 204 U. S. at page 22, 27 Sup. Ct. at page 241, 51 L. Ed. 345.

Old Wayne Life Ass'n v. McDonough was followed in *Simon v. Southern Ry. Co.*, 236 U. S. 115, 35 Sup. Ct. 255, 59 L. Ed. 492, which brought up the same question. The plaintiff sued the Southern Railway Company, a Virginia corporation, in the courts of Louisiana. That state makes it the duty of every foreign corporation doing business within its borders to file a written declaration setting forth the places in the state where it is doing business and the name of an agent upon whom process may be served. If business is done without compliance with that condition, process may be served upon the secretary of state. The Southern Railway Company did not file the required declaration. There was some question whether it did business in Louisiana at all. At all events, the cause of action had no relation to that business. It grew out of a collision in the state of Alabama. The court held that service on the secretary of state of Louisiana was not service on the railway company. It expressly refused to pass upon the effect of a voluntary appointment of an agent for the service of process: "Without discussing the right to sue on a transitory cause of action and serve the same on an agent voluntarily appointed by the foreign corporation, we put the decision here on the special fact, relied on in the court below, that in this case the cause of action arose within the state of Alabama, and the suit therefor, in the Louisiana court, was served on an agent designated by a Louisiana statute." 236 U. S. at page 130, 35 Sup. Ct. at page 260, 59 L. Ed. 492.

The question now before us is not the one that was decided in *Simon v. Southern Ry. Co.* It is the exact question which the court refused to decide. We are not required to consider how service could be made if the defendant had declined to file a stipulation. We are to ascertain the meaning and define the effect of a stipulation which it has filed. That is a question of the construction of a contract, and it must be answered in the light of the laws of the state where the contract was made. The state of New York has said that a foreign stock corporation, other than a moneyed corporation, shall not do business here until it has obtained a certificate from the secretary of state. The penalty is that it may not maintain any action in our courts "upon any contract

made by it in this state, unless before the making of the contract it has procured such certificate." General Corporation Law (Cons. Laws, c. 23) § 15. The business, though unlicensed, is not illegal; the contract is not void; it may be enforced in other jurisdictions; all that is lost is the right to sue in the courts of the state. *Lupton's Sons Co. v. Auto Club of America*, 225 U. S. 489, 32 Sup. Ct. 711, 56 L. Ed. 1177, Ann. Cas. 1914A, 699; *Mahar v. Harrington Park Villa Sites*, 204 N. Y. 231, 97 N. E. 587, 38 L. R. A. (N. S.) 210.

To obtain such a certificate, however, there are conditions that must be fulfilled. One of them is a stipulation, to be filed in the office of the secretary of state, "designating a person upon whom process may be served within this state." General Corporation Law § 16. There is no alternative provision for service on a public officer if the stipulation is not filed. The only result of the omission to file it is that the certificate does not issue. The stipulation is therefore a true contract. The person designated is a true agent. The consent that he shall represent the corporation is a real consent. He is made the person "upon whom process against the corporation may be served." The actions in which he is to represent the corporation are not limited. The meaning must therefore be that the appointment is for any action which under the laws of this state may be brought against a foreign corporation. Code Civ. Proc. §§ 432, 1780. The contract deals with jurisdiction of the person. It does not enlarge or diminish jurisdiction of the subject-matter. It means that, whenever jurisdiction of the subject-matter is present, service on the agent shall give jurisdiction of the person.

The line of division between this case, on the one side, and *Simon v. Southern Ry. Co.*, on the other, is therefore a clear one. It was marked with discrimination in the opinion of Judge Learned Hand, sitting in the United States District Court for the Southern District of New York in a case against this same defendant. *Smolik v. Philadelphia & Reading Coal & Iron Co.*, 222 Fed. 148. The distinction is between a true consent and an imputed or implied consent, between a fact and a fiction. The defendant in *Simon v. Southern Ry. Co.* had never consented to be bound by service on a public officer. "Actually it might have refused to appoint, and yet its refusal would make no difference." Hand, J., in *Smolik v. P. & R. C. & I. Co.*, *supra*. If consent is withheld, but the privilege of doing business is exercised, the courts must say to what extent the corporation shall be charged with the same consequences as if it had consented. In marking the limits of this estoppel, they are not construing a contract, but defining a duty imposed and implied by law irrespective of contract.

Two views are conceivable. On the one hand, we may say that the estoppel extends to causes of action of every nature, to causes of action which would have arisen even though the corporation had never gone beyond the state of its domicile. On the other hand, we may say that the estoppel should be limited to causes of action which owe their



origin to the transaction of business in defiance of the statutory restrictions. It is this latter and narrower view of the limits of the estoppel which has prevailed. A very different problem is the one before us. The statute is different; the conduct of the corporation subject to it is different. The statute makes no provision for service on a public officer if a designation is not filed; the corporation may withhold its stipulation and carry on business legally; all that it forfeits is the right to enforce its contracts in our courts. In return for that privilege, it has made a voluntary appointment of an agent selected by itself. We are not imposing or implying a legal duty. We are construing a contract.

When the nature of the problem is thus defined, the answer is no longer doubtful. The service of the summons on the defendant's designated agent had, we think, the same effect as if it had been made on the defendant's president. Code Civ. Proc. § 432. The purpose of the stipulation was to insure the presence in this state of some one with authority equal to the president's in respect of the service of process. It is true that even the president of a foreign corporation may be here without bringing the corporation itself within this jurisdiction. He must be here "officially, representing the corporation in its business." *Conley v. Mathieson Alkali Works*, 190 U. S. 406, 23 Sup. Ct. 728, 47 L. Ed. 1113; *Kendall v. American Automatic Loom Co.*, 198 U. S. 477, 25 Sup. Ct. 768, 49 L. Ed. 1133; *Goldey v. Morning News*, 156 U. S. 518, 15 Sup. Ct. 559, 39 L. Ed. 517. To give judgment in violation of that rule is to condemn the corporation unheard, and to ignore the essentials of due process of law. Dicta to the contrary in *Grant v. Cananea Consol. Copper Co.*, 189 N. Y. 241, 82 N. E. 191, must yield to the later decision in *Riverside & Dan River Cotton Mills v. Menefee*, 237 U. S. 189, 192, 35 Sup. Ct. 579, 59 L. Ed. 910. But when a foreign corporation is engaged in business in New York, and is here represented by an officer, he is its agent to accept service, though the cause of action has no relation to the business here transacted. That was held in *Barrow S. S. Co. v. Kane*, 170 U. S. 100, 18 Sup. Ct. 526, 42 L. Ed. 964.

The same reasoning that sustains the service of process on the president or resident officer, irrespective of the nature of the cause of action, sustains the service on this agent. Officer and agent alike are in the service of a corporation engaged in business in this state. Their presence in that service has brought the corporation within our jurisdiction; and in coming here it has become subject to the rule that transitory causes of action are enforceable wherever the defendant may be found. That was the ruling of the Supreme Court of Massachusetts in the construction of a statute similar to our own. *Johnson v. Trade Ins. Co.*, 132 Mass. 432; *Wilson v. Martin Wilson Fire Alarm Co.*, 149 Mass. 24, 27, 20 N. E. 318. That also was the ruling of the Supreme Court of Georgia. *Reeves v. Southern Ry. Co.*, 121 Ga. 561, 49 S. E. 674, 70

L. R. A. 513, 2 Ann. Cas. 207; *Hawkins v. Fidelity & Casualty Co.*, 123 Ga. 722, 51 S. E. 724; overruling *Bawknigh v. Ins. Co.*, 55 Ga. 194. We think there is nothing to the contrary either in the decisions of the Supreme Court of the nation or in the guaranty of due process under the federal Constitution.

The order should be reversed, with costs in all courts, and the question certified answered in the negative.

WILLARD BARTLETT, C. J., and CHASE, COLLIN, CUDDEBACK, SEABURY, and POUND, JJ., concur.

Order reversed.

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# CORPORATE FORMS<sup>1</sup>

## 1. CERTIFICATE OF INCORPORATION OF THE ALMADA SUGAR REFINERIES COMPANY

*(Under the New York Business Corporations Law, § 2)*

We, the undersigned, all being persons of full age, and at least two-thirds being citizens of the United States, and at least one of us a resident of the state of New York, desiring to form a stock corporation, pursuant to the provisions of the Business Corporations Law of the state of New York, do hereby make, sign, acknowledge and file this certificate for that purpose as follows, to-wit:

First. The name of the proposed corporation is

### **The Almada Sugar Refineries Company**

Second. The purposes for which it is to be formed are as follows:

To manufacture, refine, purchase, sell and deal in sugar, molasses and melada, glucose, syrup, starch, feed and such other products and by-products as are incidental thereto.

To propagate, cultivate and develop the different varieties of the grape, and to manufacture sugar, wines and brandies therefrom, and to cultivate sugar cane, sugar beets, cotton, tobacco, indigo, rice, wheat, rye, oats, corn and other products of the earth, to manufacture and prepare the same for market, and to buy, sell, deal in and transport the same.

To purchase or otherwise acquire, hold, sell and deal in landed property in the United States of America or in any colony, dependency or district thereof, in Mexico, or in any foreign or other country, and to develop the resources and to turn to account the lands, buildings and rights for the time being of the company in such manner as may be deemed desirable, and in particular by clearing, draining, irrigating, fencing, planting, building, improving, farming, grazing and mining.

To conduct and carry on the business of farmers, graziers, meat and fruit preservers, brewers, planters, miners, metallurgists, quarry owners and operators, brickmakers, builders, contractors for the construction of works, both public and private, merchants, importers and exporters, printers, publishers, brokers, shipbuilders, shipowners, and the business of using, hiring and operating ships, boats, steam, sail and other vessels in connection with the operations of the company.

<sup>1</sup> The author is indebted to Hon. Frank White for permission to reprint forms 1-8, inclusive, from White on Corporations (8th Ed.).

To acquire water by purchase, development or otherwise; to construct dams, reservoirs, water towers and water ways, laying of water mains, pipes, gates, valves and hydrants; to furnish and sell water to manufactories, private corporations, associations, firms and individuals for fire protection, manufacturing, power, irrigating and domestic purposes, and collect payment of rentals for the same.

To construct, equip, improve and develop public and private works of all kinds, including railways, railroads, docks, harbors, piers, wharves, canals, reservoirs, sewage, drainage, sanitary, water, gas, power supply works, warehouses, and buildings, public or private, tunnels, bridges, conduits, viaducts and all other works of public or private use or utility, and also to build, own, purchase or otherwise acquire for its own use and operation railways and railroads, but such use and operation to be solely in connection with and appurtenant to the business of the corporation as herein set forth and not for public purposes.

To manufacture, purchase, or otherwise acquire, deal in, hold, own, manage, sell, pledge, transfer, or otherwise dispose of, goods, wares, merchandise and property of any and every class and description.

To acquire the good will, rights and property of any person, firm, association or corporation, and to pay for the same in cash, the stock of this company, bonds or otherwise, and to hold or in any manner dispose of the whole or any part of the property so purchased; or to conduct in any lawful manner the whole or any part of the business so acquired, provided such business is within the authorization of the Business Corporations Law, and to exercise all the powers necessary or convenient in and about the conducting and management of such business.

To purchase or otherwise acquire, hold, own, mortgage, pledge, sell, assign, transfer, and generally to invest, trade and deal in personal property of every class and description.

To buy, sell, deal in, lease, hold or improve real estate, and the fixtures and personal property incidental thereto or connected therewith, and, with that end in view, to acquire, by purchase, lease, hire or otherwise, lands, tenements, hereditaments, or any interest therein, and to improve the same, and generally to hold, manage, deal with and improve the property of the company, and to sell, lease, mortgage, pledge or otherwise dispose of the lands, tenements, and hereditaments or other property of the company.

To apply for, obtain, register, purchase, lease or otherwise to acquire and to hold, use, own, operate and introduce, and to sell, assign or otherwise dispose of, any trade-marks, trade-names, patents, inventions, improvements and processes used in connection with or secured under letters patent of the United States, or elsewhere or otherwise, and to use, exercise, develop, grant licenses in respect of, or otherwise turn to account any such trade-marks, patents, licenses, processes and the like, or any such property or rights: Provided always

that the terms "use" and "operate" shall not be deemed to include any business except such as is permitted by the Business Corporations Law.

To purchase, acquire, hold, dispose of the stocks, bonds and other evidences of indebtedness of any corporation, domestic or foreign, and to issue in exchange therefor its stock, bonds or other obligations, and, while owner of any such stock, bonds or other obligations, to possess and exercise in respect thereof, all the rights, powers and privileges of individual owners or holders thereof, and to exercise any and all voting power thereon.

To make, purchase, or otherwise acquire, deal in, and to carry out any contracts for or in relation to any of the foregoing businesses that may be necessary and lawful under the act pursuant to which this corporation is organized.

To make any guaranty respecting dividends, stocks, bonds, contracts or other obligations so far as the same may be permitted by corporations organized under said Business Corporations Law.

To do all and everything necessary, suitable and proper for the accomplishment of any of the purposes or the attainment of any of the objects or the furtherance of any of the powers hereinbefore set forth, either alone or in association with other corporations, firms or individuals, and to do every other act or acts, thing or things incidental or appurtenant to or growing out of or connected with the aforesaid business or powers or any part or parts thereof, provided the same be not inconsistent with the laws under which this corporation is organized.

Third. The amount of the capital stock is three million five hundred thousand dollars (\$3,500,000).

Fourth. The number of shares of which the capital stock shall consist is thirty-five thousand (35,000), of the par value of one hundred dollars (\$100) each, and the amount of capital with which said corporation will begin business is one thousand dollars (\$1,000).

Fifth. The principal business office of the corporation is to be located in the city of New York, county of New York, state of New York, but the corporation shall have power to conduct its business in all its branches, or any part thereof, in any of the states, territories, colonies and dependencies of the United States, in the District of Columbia and in any and all foreign or other countries, to have one or more offices therein, to hold, purchase, mortgage and convey real and personal property without limit as to amount, in any such state, territory, colony, dependency, district or foreign or other country, but always subject to the laws thereof.

Sixth. Its duration is to be perpetual.

Seventh. The number of its directors is to be ———, and it is hereby provided, pursuant to law, that directors are not required to be stockholders.



Eighth. The names and post-office addresses of the directors for the first year are as follows:

Names	Post-Office Addresses
_____	_____
_____	_____
_____	_____

Ninth. The post-office addresses of the subscribers of this certificate and a statement of the number of shares of stock which each agrees to take in the corporation, are as follows:

Names	Post-Office Addresses	Number of Shares
_____	_____	_____
_____	_____	_____
_____	_____	_____

In witness whereof, we have made, signed and acknowledged this certificate in duplicate.

Dated this 8th day of October, 1901.

*(Here follow signatures of the incorporators and acknowledgment.)*

## 2. BY-LAWS FOR STOCK CORPORATIONS

*(See the New York General Corporation Law, § 11)*

### BY-LAWS OF THE ——— COMPANY

#### ARTICLE I.—MEETING OF STOCKHOLDERS

Section 1. The annual meeting of the stockholders of this company shall be held at the office of the corporation, in the ——— of ———, on the (*e. g.*, second Monday in January) of each and every year, at 12 o'clock, noon, for the election of directors and such other business as may properly come before said meeting. Notice of the time, place and object of such meeting shall be given by publication thereof, at least once in each week for two successive weeks immediately preceding such meeting, in the manner required by the Stock Corporation Law, section 25, and by serving personally or by mailing, at least ——— days previous to such meeting, postage prepaid, a copy of such notice, addressed to each stockholder at his residence or place of business, as the same shall appear on the books of the corporation. No business, other than that stated in such notice, shall be transacted at such meeting without the unanimous consent of all the stockholders present thereat, in person or proxy.

Section 2. Special meetings of stockholders, other than those regulated by statute, may be called at any time by a majority of the directors. It shall also be the duty of the president to call such meetings whenever requested in writing, so to do, by stockholders owning ——— of the capital stock. A notice of every special meeting, stating

the time, place and object thereof, shall be given by mailing, postage prepaid, at least —— days before such meeting, a copy of such notice addressed to each stockholder at his post-office address as the same appears on the books of the corporation.

Section 3. At all meetings of stockholders there shall be present, either in person or by proxy, stockholders owning —— of the capital stock of the corporation in order to constitute a quorum, except at special elections of directors pursuant to section 30 of the General Corporation Law.

Section 4. At all annual meetings of stockholders the right of any stockholder to vote shall be governed and determined as prescribed in the General Corporation Law, sections 23, 26, and 27.

Section 5. If, for any reason, the annual meeting of stockholders shall not be held as hereinbefore provided, such annual meeting shall be called and conducted as prescribed in the General Corporation Law, sections 28, 29, 30, and 31.

Section 6. At all —— meetings of stockholders, only such persons shall be entitled to vote in person and by proxy who appear as stockholders upon the transfer books of the corporation for —— days immediately preceding such meeting.

Section 7. At the annual meetings of stockholders the following shall be the order of business, viz:

1. Calling the roll.
2. Proof of proper notice of meeting.
3. Report of president.
4. Report of treasurer.
5. Report of secretary.
6. Report of committees.
7. Election of directors.
8. Miscellaneous business.

Section 8. At all meetings of stockholders all questions, except the question of an amendment to the by-laws, and the election of directors, and inspectors of election, and all such other questions, the manner deciding which is specially regulated by statute, shall be determined by a majority vote of the stockholders present in person or by proxy: Provided, however, that any qualified voter may demand a stock vote, and in that case, such stock vote shall immediately be taken, and each stockholder present, in person or by proxy, shall be entitled to one vote for each share of stock owned by him. All voting shall be viva voce, except that a stock vote shall be by ballot, each of which shall state the name of the stockholder voting and the number of shares owned by him, and in addition, if such ballot be cast by a proxy, it shall also state the name of such proxy.

Section 9. At special meetings of stockholders the provisions of sections 23, 26, 27, and 31 of the General Corporation Law shall apply to the casting of all votes.

## ARTICLE II.—DIRECTORS

Section 1. The directors of this corporation shall be elected by ballot, for the term of one year, at the annual meeting of stockholders, except as hereinafter otherwise provided for filling vacancies. The directors shall be chosen by a plurality of the votes of the stockholders, voting either in person or by proxy, at such annual election as provided by section 25 of the Stock Corporation Law.

Section 2. Vacancies in the board of directors, occurring during the year, shall be filled for the unexpired term, by a majority vote of the remaining directors at any special meeting called for that purpose, or at any regular meeting of the board.

Section 3. In case the entire board of directors shall die or resign, any stockholder may call a special meeting in the same manner that the president may call such meetings, and directors for the unexpired term may be elected at such special meeting in the manner provided for their election at annual meetings.

Section 4. The board of directors may adopt such rules and regulations for the conduct of their meetings and management of the affairs of the corporation as they may deem proper, not inconsistent with the laws of the State of New York, or these by-laws.

Section 5. The board of directors shall meet on the (*e. g.*, second Monday) of every month, and whenever called together by the president upon due notice given to each director. On the written request of any director the secretary shall call a special meeting of the board.

Section 6. All committees shall be appointed by the board of directors.

## ARTICLE III.—OFFICERS

Section 1. The board of directors, immediately after the annual meeting, shall choose one of their number by a majority vote to be president, and they shall also appoint a vice president, secretary and treasurer. Each of such officers shall serve for the term of one year, or until the next annual election.

Section 2. The president shall preside at all meetings of the board of directors, and shall act as temporary chairman at, and call to order all meetings of the stockholders. He shall sign certificates of stock, sign and execute all contracts in the name of the company, when authorized so to do by the board of directors; countersign all checks drawn by the treasurer; appoint and discharge agents and employes, subject to the approval of the board of directors; and he shall have the general management of the affairs of the corporation and perform all the duties incidental to his office.

Section 3. The vice president shall, in the absence or incapacity of the president, perform the duties of that officer.

Section 4. The treasurer shall have the care and custody of all the funds and securities of the corporation, and deposit the same in



the name of the corporation in such bank or banks as the directors may elect; he shall sign all checks, drafts, notes and orders for the payment of money, which shall be countersigned by the president, and he shall pay out and dispose of the same under the direction of the president; he shall at all reasonable times exhibit his books and accounts to any director or stockholder of the company upon application at the office of the company during business hours; he shall sign all certificates of stock signed by the president; he shall give such bonds for the faithful performance of his duties as the board of directors may determine.

Section 5. The secretary shall keep the minutes of the board of directors, and also the minutes of the meetings of stockholders; he shall attend to the giving and serving of all notices of the company, and shall affix the seal of the company to all certificates of stock, when signed by the president and treasurer; he shall have charge of the certificate book and such other books and papers as the board may direct; he shall attend to such correspondence as may be assigned to him, and perform all the duties incidental to his office. He shall also keep a stock-book, containing the names, alphabetically arranged, of all persons who are stockholders of the corporation, showing their places of residence, the number of shares of stock held by them respectively, the time when they respectively became the owners thereof, and the amount paid thereon, and such book shall be open for inspection as prescribed by section 33 of the Stock Corporation Law.

#### ARTICLE IV.—CAPITAL STOCK

Section 1. Subscriptions to the capital stock must be paid to the treasurer at such time or times, or in such installments, as the board of directors may by resolution require. Any failure to pay an installment when required to be paid by the board of directors shall work a forfeiture of such shares of stock in arrears, pursuant to section 54 of the Stock Corporation Law.

Section 2. Certificates of stock shall be numbered and registered in the order they are issued, and shall be signed by the president or vice president and by the secretary or treasurer, and the seal of the corporation shall be affixed thereto. All certificates shall be bound in a book, and shall be issued in consecutive order therefrom, and in the margin thereof shall be entered the name of the person owning the shares therein represented, the number of shares, and the date thereof. All certificates exchanged or returned to the corporation shall be marked canceled, with the date of cancellation, by the secretary, and shall be immediately pasted in the certificate book, opposite the memorandum of its issue.

Section 3. Transfers of shares shall only be made upon the books of the corporation by the holder in person or by power of attorney duly executed and acknowledged and filed with the secretary of the

corporation, and on the surrender of the certificate or certificates of such shares.

Section 4. Whenever the capital stock of the corporation is increased, each bona fide owner of its stock shall be entitled to purchase, at the par value thereof, an amount of stock in proportion to the numbers of shares of stock he owns in the corporation at the time of such increase.

#### ARTICLE V.—DIVIDENDS

Section 1. Dividends shall be declared and paid out of the surplus profits of the corporation as often and at such times as the board of directors may determine, and in accordance with section 28 of the Stock Corporation Law.

#### ARTICLE VI.—INSPECTORS

Section 1. Two inspectors of election shall be elected at each annual meeting of stockholders to serve for one year, and if any inspector shall refuse to serve or shall not be present, the meeting may appoint an inspector in his place.

#### ARTICLE VII.—SEAL

Section 1. The seal of the corporation shall be in the form of a circle, and shall bear the name of the corporation and the year of its incorporation.

#### ARTICLE VIII.—AMENDMENTS

Section 1. These by-laws may be amended at any stockholders' meeting by a vote of the stockholders owning a majority of the stock, represented either in person or by proxy, provided the proposed amendment is inserted in the notice of such meeting. A copy of such amended by-law shall be sent to each stockholder within ten days after the adoption of the same.

#### ARTICLE IX.—WAIVER OF NOTICE

Section 1. Whenever under the provisions of these by-laws or of any of the corporate laws the stockholders or directors are authorized to hold any meeting after notice or after the lapse of any prescribed period of time, such meeting may be held without notice and without such lapse of time by a written waiver of such notice signed by every person entitled to notice.

### 3. MINUTES OF FIRST MEETING OF INCORPORATORS

The first meeting of the incorporators and subscribers to the capital stock of the (*insert name*) Company was held at No. ——— street (*or*, at the ——— Hotel, *or*, at the office of ———, No. ——— street, *as the case may be*), in the city (village *or* town) of ———, state of New York, on the ——— day of ———, 19—, at ——— o'clock in the forenoon.

Mr. George L. Hunter called the meeting to order and stated the purposes thereof.

Upon motion, Mr. George L. Hunter was chosen chairman of the meeting, and Mr. Matthew Miller secretary thereof.

All the incorporators, being also all the subscribers to the capital stock of the company, were personally present as follows, to wit:

Name	Shares Subscribed
James A. Byrne.....	1
Matthew Miller.....	1
George L. Hunter.....	1

(*Or*, All the incorporators, being also all the stockholders of the company, were present, either in person or by proxy, as follows:)

Present in Person	Shares Subscribed
James A. Byrne.....	1
Matthew Miller.....	1
George L. Hunter.....	1

Present by Proxy	Name of Proxy	Shares Subscribed
Jonas L. Hall.....	William J. Phelps.....	1
Henry R. Fulton.....	Frank M. Clark.....	1

A written waiver of notice and an agreement duly signed by all the incorporators, fixing the time and place of this meeting, was presented by the secretary, and it was ordered that a copy thereof be prefixed to the record of the minutes of this meeting.

The chairman then presented a copy of the certificate of incorporation and stated to the meeting that on October 15, 1909, an original certificate of incorporation, duly executed and acknowledged, had been duly filed and recorded in the office of the secretary of state, at Albany, N. Y., that on October 16, 1909, a duplicate (*or*, certified copy) thereof had been duly filed and recorded in the office of the clerk of the county of ———, that the organization tax had been duly paid to the treasurer of the state of New York, and that the statutory filing and recording fees had been paid to the secretary of state and said county clerk respectively.



It was thereupon

Ordered, that said copy of the certificate of incorporation be filed and that a copy thereof be prefixed to the record of the minutes of this meeting.

The chairman submitted for the consideration of the meeting the proposed by-laws, and stated that the same had been prepared by the counsel of the company, in accordance with the instructions of the incorporators.

After discussion and consideration, and by unanimous vote, it was

Resolved, that the by-laws now submitted to this meeting be and hereby are adopted as the by-laws of the corporation and that said by-laws be prefixed to the minutes of this meeting.

The secretary presented to the meeting a written proposal from the firm of Horatio Taylor & Co., offering to sell and transfer to this company the business of manufacturers of harness and saddlery now owned and conducted by said firm at No. 617 Mercer street, New York City.

It was thereupon

Ordered, that said proposal be placed on file and that a copy thereof be prefixed to the record of the minutes of this meeting.

After discussion and consideration of the offer made, and by the affirmative vote of all present (*or*, by an unanimous vote) the following preambles and resolution were adopted:

Whereas, the firm of Horatio Taylor & Co. has offered to sell, transfer and assign to this company the business of manufacturers of harness and saddlery now owned and conducted by said firm at No. 617 Mercer street, New York City, and all the right, title and interest of said firm in and to the same, including the good will thereof, lease, stock on hand and in process of manufacture, raw materials, tools, machines, fixtures and appurtenances, horses and wagons, trade-marks, trade-names, brands, formulæ, books, bills and accounts receivable, contracts, and personal property of every name and description used in the conduct of said business and owned by said firm; and

Whereas, said firm offers to accept as full consideration for said sale, transfer and assignment of said business and property ——— shares of the capital stock of this company and the assumption by this company of its indebtedness, not exceeding \$———; and

Whereas, it appears that said business and property has an actual value to the amount of the consideration demanded therefor and that it is to the best interests of this company to accept said offer: Now, therefore, it is hereby

Resolved, that said offer, as set forth in said proposition, be and hereby is approved, and it is recommended that the board of directors of this company should accept the said proposition and cause the issuance of the ——— shares of the capital stock of this company and

the assumption of the indebtedness of said firm, not exceeding \$—— as full consideration and payment for the business and property so to be sold, assigned and conveyed to this company.

There being no further business before the meeting it was adjourned.

Matthew Miller, Secretary.

George L. Hunter, Chairman.

#### 4. MINUTES OF FIRST MEETING OF DIRECTORS

The first meeting of the board of directors of the (*insert name*) Company was held at No. —— street (*or*, at the —— Hotel, *or*, at the office of ——, No. —— street, *as the case may be*), in the city (village *or* town) of ——, state of New York, on the —— day of ——, 19——, at —— o'clock in the forenoon.

There were present ——, —— and ——, being all of the directors of the company.

Mr. —— called the meeting to order, and, on motion —— and —— were chosen chairman and secretary, respectively, of the meeting.

The secretary presented a written waiver of notice of the meeting, signed by all the directors, and upon motion it was ordered that the same be filed and that a copy thereof be prefixed to the record of the minutes of this meeting.

The secretary presented the minutes of the first meeting of the incorporators and stockholders, held this day.

The secretary presented the by-laws adopted at the first meeting of incorporators and stockholders, and thereupon said by-laws were unanimously ratified, confirmed and approved as and for the by-laws of the company.

Upon motion, duly adopted, it was

Resolved, that the seal of this corporation be the impression upon wax or paper of the device prescribed by the by-laws, and in the form impressed upon this page.

The secretary presented a form of stock certificate for approval, which was, upon motion, duly adopted as the stock certificate of the company, and the secretary was instructed to affix a sample copy thereof to the minute book immediately preceding the record of this meeting.

Upon motion, duly made and adopted, it was

Resolved, that the funds of this company, until further ordered, be deposited in its name with the —— Bank (*or*, —— Trust Company), and that the same be subject to check made in the corporate name, signed by the president (*or as the case may be*), and countersigned by the treasurer (*or*, secretary), and that a copy of this resolution, certified by the secretary, be transmitted to the said bank (*or*, Trust Company).

Upon motion, duly adopted, it was

Resolved, that the principal office of the company be located at No. \_\_\_\_\_ street, in the city (village or town) of \_\_\_\_\_, state of New York.

Further resolved, that the proper officers of this company be and hereby are authorized and directed to make and execute, in the name and on behalf of this corporation, the lease of the said office.

*(If officers are to have salaries, the following is suggested):*

Upon motion, unanimously adopted, it was

Resolved, that the annual compensation of each of the officers of the corporation be and is hereby fixed as follows:

President, \$\_\_\_\_\_.

Vice president, \$\_\_\_\_\_.

Treasurer, \$\_\_\_\_\_.

Secretary, \$\_\_\_\_\_.

Upon motion, the following officers were elected for the ensuing year, to wit:

President, \_\_\_\_\_.

Vice president, \_\_\_\_\_.

Treasurer, \_\_\_\_\_.

Secretary, \_\_\_\_\_.

The secretary presented a written proposal from the firm of Horatio Taylor & Co., offering to sell and transfer to this company the business of manufacturers of harness and saddlery now owned and conducted by said firm at No. 617 Mercer street, New York city.

There was also presented a resolution of the stockholders, approving the said proposal and recommending that the board of directors accept the same upon the terms and conditions therein set forth.

After discussion it was determined that the business and property thus offered was of the reasonable value of the consideration demanded for the same, and thereupon, by the affirmative vote of all present, the following preambles and resolution were adopted:

Whereas, the firm of Horatio Taylor & Co. has offered to sell, transfer and assign to this company the business of manufacturers of harness and saddlery now owned and conducted by said firm at No. 617 Mercer street, New York City, as more fully appears in the written proposal on file in this office; and

Whereas, the stockholders of this company, at a meeting duly held, approved the said proposal and recommended that the board of directors accept the same; and

Whereas, in the judgment of this board of directors said business and property are reasonably worth the amount of the consideration demanded therefor, that the same is necessary for the use and lawful purposes of the company, and that it is deemed to be for the best interests of this company to accept said offer, as set forth in said proposition: Now, therefore,



Resolved, that said offer, as set forth in said proposition, be and is hereby approved and accepted, and that, in accordance with the terms thereof, this company shall, as full payment for said property and business, issue and deliver ——— shares of its capital stock, of the total par value of \$———, to said firm of Horatio Taylor & Co., or to their nominees or assigns, in such proportions as may be designated by them, and shall also assume the indebtedness of said firm, but not exceeding \$———, and,

Further resolved, that the president and treasurer (*or as the case may be*) of this company are hereby authorized and directed, upon delivery of said business and property, as set forth in said proposition, and the execution and delivery of a proper instrument or instruments necessary to transfer and convey the same, to issue and deliver in accordance with these resolutions ——— shares of the capital stock of this company.

*(If the issue of only a portion of the capital stock has been provided for it may be desirable to adopt the following:)*

Upon motion, duly adopted by the affirmative vote of a majority present (*or, by unanimous vote*), it was

Resolved, that subscriptions for the remainder of the capital stock be opened at the office of the company after giving such notices as may be deemed expedient, and that at the time of subscribing every subscriber whose subscription is payable in money shall be required to pay to the treasurer at least ten per centum upon the amount subscribed by him in cash.

Upon motion, duly adopted, it was

Resolved, that the secretary be and he hereby is authorized and directed to procure proper corporate books, stationery, and office furniture.

*(If the corporation is to have inspectors of election, adopt a resolution as follows:)*

Upon motion, duly adopted, it was

Resolved, that Messrs. Matthew Miller and Jonas L. Hall be and they are hereby appointed inspectors of election to serve at the first annual meeting of the company, and at any meeting of the stockholders that may be held prior thereto.

*(If any of the directors named in the certificate of incorporation were to act only temporarily, during organization of the company, the following is suggested:)*

James A. Byrne presented his resignation as a director of the company, to take effect immediately, which was, upon motion, accepted, and the meeting then, upon motion, filled the vacancy by the election of Silas R. Flower, who, being present, thereupon accepted.

There being no further business before the meeting, it was adjourned.

———, Chairman.

———, Secretary.

## 5. AGREEMENT AND SUBSCRIPTION PRIOR TO INCORPORATION

We, the undersigned, hereby agree to form a stock corporation under the Business Corporations Law of the State of New York for the purpose of \_\_\_\_\_ under the name of \_\_\_\_\_; and for such purpose we mutually agree to pay to the treasurer appointed by said company the amount set opposite our respective names in the manner following: Fifty per cent. on demand, 25 per cent. on \_\_\_\_\_, and 25 per cent. thereafter when demanded by said company.

It is further mutually agreed that the capital stock of said company shall be \$100,000, divided into 1,000 shares, of the par value of \$100 each, of which said amount \$50,000 shall be common stock and \$50,000 thereof shall be preferred stock, entitled to preferences over the common stock as follows: \_\_\_\_\_.

It is further mutually agreed that \_\_\_\_\_ be and he is hereby authorized for us and in our behalf to cause to be prepared, executed, filed and recorded such certificate of incorporation as may be necessary and to do all things and perform all acts required for the formation of the company hereby agreed to be formed.

This agreement may be executed in several counterparts, each of which so executed shall be deemed to be an original, and such counterparts shall together constitute but one and the same instrument.

Name	Address	Number of Shares		Amount
		Preferred	Common	
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____

## 6. PROXY FROM A STOCKHOLDER

(See the New York General Corporation Law, § 26)

Know all men by these presents, that I, \_\_\_\_\_, do hereby constitute and appoint C. D. to be my lawful attorney, substitute and proxy, for me and in my name to vote upon all the stock held by me in (*insert name of corporation*) at the annual meeting of stockholders of such corporation (*or, at a special meeting of such corporation, as the case may be*), to be held on the \_\_\_\_\_ day of \_\_\_\_\_, 19—, and at any adjourned meeting thereof, as fully and with the same effect as I might or could do, were I personally present at such meeting; and I hereby revoke any proxy or proxies heretofore given by me to any person or persons whatsoever.

In witness whereof, I have hereunto set my hand and seal this \_\_\_\_\_ day of \_\_\_\_\_, 19—. (Signature.) (L. S.)

In presence of \_\_\_\_\_.

## 7. EXECUTIVE COMMITTEE AND FINANCE COMMITTEE

*(From By-Laws of the United States Steel Corporation)*

Section 1. The board of directors shall elect from the directors an executive committee and a finance committee, and shall designate for each of those committees a chairman, who shall continue to be chairman of the committee during the pleasure of the board of directors.

The board of directors shall fill vacancies in the executive committee or in the finance committee by election from the directors; and at all times it shall be the duty of the board of directors to keep the membership of each of such committees full, with due regard to the qualifications for such membership indicated in this article of the by-laws.

All action by the executive committee or by the finance committee shall be reported to the board of directors at its meeting next succeeding such action, and shall be subject to revision or alteration by the board of directors: Provided that no rights or acts of third parties shall be affected by any such revision or alteration.

The executive committee and the finance committee each shall fix its own rules of proceeding, and shall meet where and as provided by such rules, or by resolution of the board of directors, but in every case the presence of a majority shall be necessary to constitute a quorum.

In every case the affirmative vote of a majority of all of the members of the committee shall be necessary to the adoption of any resolution.

The chairman and each of the members of the executive committee shall receive such compensation for their services as from time to time shall be fixed by the finance committee and be approved by the board of directors.

Section 2. The executive committee shall consist of six members, besides the president and the chairman of the finance committee, each of whom, by virtue of his office, shall be a member of the executive committee. So far as practicable each of the six elected members of the executive committee shall be a person having, or having had, personal experience in the conduct of one or the other of the branches of manufacture or mining, or of transportation in which the company is interested, and so far as practicable the six elected members shall be taken equally from the three classes of directors. Unless otherwise ordered by the board of directors, each elected member of the executive committee shall continue to be a member thereof until the expiration of his term of office as a director.

During the intervals between the meetings of the board of directors, the executive committee shall possess and may exercise all the powers of the board of directors in the management and direction of the



manufacturing, mining and transportation operations of the company, and of all the business and affairs (except the matters hereinafter assigned to the finance committee) in such manner as the executive committee shall deem best for the interests of the company, in all cases in which specific directions shall not have been given by the board of directors.

During the intervals between the meetings of the executive committee the chairman thereof shall possess, and may exercise, such of the powers vested in the executive committee as from time to time may be conferred upon him by resolution of the board of directors, or of the executive committee.

Section 3. The finance committee shall consist of four members, besides the president and the chairman of the executive committee, each of whom, by virtue of his office, shall be a member of the finance committee. So far as practicable each of the four elected members of the finance committee shall be a person of experience in matters of finance, and so far as practicable the four elected members shall be taken equally from the three classes of directors. Unless otherwise ordered by the board of directors, each elected member of the finance committee shall continue to be a member thereof until the expiration of his term of office as a director.

The finance committee shall have special and general charge and control of all financial affairs of the company. The general counsel, the treasurer, the comptroller and the secretary, and their respective offices, shall be under the direct control and supervision of the finance committee.

During the intervals between the meetings of the board of directors, the finance committee shall possess, and may exercise, all the powers of the board of directors in the management of the financial affairs of the company, including its purchases of property, and the execution of legal instruments with or without the corporate seal, in such manner as said committee shall deem to be best for the interests of the company, in all cases in which specific directions shall not have been given by the board of directors.

During the intervals between the meetings of the finance committee, and subject to its review, the chairman thereof shall possess and may exercise any of the powers of the committee, except as from time to time shall be otherwise provided by resolution of the board of directors or of the finance committee, but not of the executive committee.

Except as otherwise provided by the by-laws, or by resolution of the board of directors, all salaries and compensations paid or payable by the company shall be fixed by the finance committee.

## 8. VOTING TRUST AGREEMENT

This agreement, made on the \_\_\_\_\_ day of \_\_\_\_\_, 1901, between \_\_\_\_\_, owners and holders of shares of the capital stock of the \_\_\_\_\_ Company, a corporation organized and existing under the laws of the state of \_\_\_\_\_, and any other owners and holders of shares of the capital stock of the said company who may hereafter become parties or assent hereto, each for himself and not for the others, hereinafter called "the stockholders," parties of the first part, and the \_\_\_\_\_ Trust Company, hereinafter called "the trustee," party of the second part.

Whereas, the \_\_\_\_\_ Company has but recently come into existence, and the success or failure of the business enterprise depends largely upon the management and policy of the said company during the first years of its existence; and

Whereas, the said parties of the first part believe that it is essential for the success of said company, and for the best interests of all the stockholders thereof, that the said company shall be managed and directed during the first five years of its existence under a definite and fixed policy, and to secure a union of all interests in order to properly develop the rights, privileges, franchises and property owned by the said corporation; and

Whereas, the said stockholders have this day transferred and delivered to the voting trustee certificates for fully paid shares of one hundred dollars each of the capital stock of the \_\_\_\_\_ Company, as follows:

\_\_\_\_\_ shares,  
\_\_\_\_\_ shares,

which certificates, together with such other similar certificates as may hereafter from time to time be delivered hereunder by the other stockholders of said company, are hereby received and will be received by and are to be held and disposed of by the voting trustees under and pursuant to the terms and conditions hereof.

Now, therefore:

First. The voting trustee does hereby promise and agree with the aforesaid stockholders individually that the voting trustee will cause to be issued and delivered to each of said stockholders individually a certificate for the number of shares transferred and delivered to the voting trustee as hereinbefore set forth in substantially the following form:

\_\_\_\_\_ Company

### Common Stock Trust Certificates

This is to certify, that as hereinafter provided \_\_\_\_\_ will be entitled to receive a certificate or certificates for \_\_\_\_\_ fully paid shares of the par value of one hundred dollars each, in common stock of

the capital stock of the ——— Company, on the ——— day of ———, 19—, and in the meantime to receive payments equal to the dividend, if any, collected by the undersigned voting trustee upon a like number of such shares standing in its name, and until after actual delivery of such stock certificates the voting trustee shall possess and shall be entitled to exercise all rights of every name and nature, including the right to vote in respect to any and all such stock, it being expressly stipulated that no voting right passes by or under this certificate or by or under any agreement express or implied.

This certificate is issued under and pursuant to the terms and conditions of a certain agreement dated the ——— day of ———, 1901, by and between certain of the stockholders of the ——— Company and the undersigned voting trustee.

This certificate is transferable only on the books of the undersigned voting trustee, by the registered holder either in person or by attorney duly authorized, according to the rules established for that purpose by the undersigned voting trustee, and on surrender hereof and cancellation or transfer the undersigned voting trustee may treat the registered holder as owner hereof for all purposes whatsoever, except that the delivery of stock certificates hereunder shall not be made without the surrender hereof.

In witness whereof, the undersigned voting trustee has executed this certificate this ——— day ———, 19—.

———, Voting Trustee.

Second. That on the ——— day of ———, 19—, the voting trustee in exchange for and upon the surrender of the aforesaid trust certificates then outstanding will, in accordance with the terms thereof, deliver or cause to be delivered proper certificates of equivalent amount of stock of the ——— Company.

Third. The voting trustee shall cause the above-mentioned deposited shares of the capital stock of the ——— Company to be transferred on the books of said company to the name of the voting trustee.

Fourth. From time to time hereafter the voting trustee will receive such additional fully paid shares of the capital stock of the ——— Company as any and all other stockholders of said company may tender and deliver to said voting trustee hereunder, and in respect of all such shares so received will issue and deliver certificates similar to those above mentioned, entitling the holders to all rights above specified.

Fifth. In voting stock held by it, the voting trustee shall exercise its best judgment from time to time to select suitable directors to the end that the business and affairs of the ——— Company shall be properly managed, and in voting on any other matters which may come before it at any stockholders' meeting, will exercise like judgment, but it assumes no responsibility in respect to such management or in respect of any action taken pursuant to its vote so cast, it being understood that the voting trustee incurs no responsibility by reason



of any error of judgment or by law in any matter or thing done or omitted under this agreement, except for its own gross negligence or wilful malfeasance.

Sixth. This agreement shall be open for inspection at the office of the voting trustee in the city of — during ordinary business hours to any stockholder of the said — Company.

In witness whereof, the several parties hereto have hereunto set their hands and seals in the city of New York the day and year first above written.

In the presence of:

(Signatures.)

## 9. CERTIFICATE OF STOCK IN JOINT STOCK CORPORATION

Incorporated under the Laws of the State of New York

Authorized Capital Stock, \$320,000

No. —.

— Shares.

### JOINT STOCK CORPORATION

This is to certify, that — is the owner of — shares, of the par value of one hundred dollars (\$100) each of the capital stock of Joint Stock Corporation, transferable only on the books of the company by the holder hereof, in person or by duly authorized attorney, upon surrender of this certificate properly endorsed.

This certificate is issued subject to the provision of the by-laws of the company that treasury stock may be issued either for money or in payment of shares of stock, bonds or other obligations and any other form of property, at such prices, not less than par, as the board of directors may, from time to time, in their discretion determine, and without such stock having been first offered to the stockholders of the company.

In witness whereof, the said company has caused its corporate seal to be hereunto affixed and this certificate to be signed by its president or its vice president and by its secretary this — day of —, 19—.

—, Secretary.

—, President.

## 10. CERTIFICATE OF COMMON STOCK IN CORPORATION

Incorporated under the Laws of the State of Maine

No. \_\_\_\_\_ Shares.

GENERAL SILK IMPORTING COMPANY, INC.

Capital Stock, \$1,000,000 Shares, \$100 Each

This is to certify that \_\_\_\_\_ is the owner of \_\_\_\_\_ shares of the capital stock of General Silk Importing Company, Inc., transferable only on the books of the company in person or by attorney, upon surrender of this certificate, properly endorsed.

In witness whereof, the corporation has caused this certificate to be signed by its duly authorized officers, and to be sealed with its corporate seal, this \_\_\_\_\_ day of \_\_\_\_\_, A. D. 19—.

\_\_\_\_\_, Treasurer.

\_\_\_\_\_, President.

## 11. CERTIFICATE OF PREFERRED STOCK IN CORPORATION

Incorporated under the Laws of the Commonwealth of Virginia

No. \_\_\_\_\_ Shares.

FREEPORT & TAMPICO FUEL OIL CORPORATION

Common Stock \$10,000,000 Preferred Stock \$300,000

Shares \$100 Each.

This certifies that \_\_\_\_\_ is the owner of \_\_\_\_\_ full paid non-assessable shares of the par value of one hundred dollars (\$100) each of the preferred capital stock of Freeport & Tampico Fuel Oil Corporation, transferable only on the books of the corporation by the holder in person or by attorney, upon surrender of this certificate properly endorsed. The preferred stock is entitled to a cumulative dividend at the rate of six per cent. per annum and shall be paid and retired at par and accrued dividends from time to time from the net earnings of the corporation to the extent of one-half of such net earnings, in the manner permitted by the laws of the state of Virginia, the time, manner and conditions of such payment and retirement being subject to the provisions of the charter and by-laws of the corporation.

In witness whereof the said corporation has caused this certificate to be signed by its president and secretary and to be sealed with the

corporate seal of the corporation this \_\_\_\_\_ day of \_\_\_\_\_, A. D. one thousand nine hundred and \_\_\_\_\_.

Freeport and Tampico Fuel Oil Corporation,  
\_\_\_\_\_, Secretary. \_\_\_\_\_, President.

Countersigned and registered:

Central Trust Company of New York, Registrar.

By \_\_\_\_\_, Secretary.

Countersigned: \_\_\_\_\_, Transfer Agent.

## 12. ASSIGNMENT OF CERTIFICATE OF STOCK

For value received, \_\_\_\_\_ hereby sell, assign and transfer unto \_\_\_\_\_, \_\_\_\_\_ shares of the capital stock represented by the within certificate, and do hereby irrevocably constitute and appoint \_\_\_\_\_ attorney to transfer the said stock on the books of the within named company, with full power of substitution in the premises.

Dated \_\_\_\_\_, 19—.

(Signature)

In Presence of \_\_\_\_\_.

Notice: The signature to this assignment must correspond with the name as written upon the face of the certificate in every particular, without alteration or enlargement, or any change whatever.







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